APPENDIX A

STATE OF MICHIGAN

COURT OF APPEALS

SHR LIMITED PARTNERSHIP,

Plaintiff/Counter Defendant-Appellant,

v

MERCURY EXPLORATION COMPANY,

DOMINION RESERVES, INC., and QUICKSILVER RESOURCES, INC.,

Defendants/Counter Plaintiffs-Appellees.

UNPUBLISHED
December 6, 2002

No. 232466

Otsego Circuit Court
LC No. 99-008060-CK

Before: Hood, P.J., and Whitbeck, C.J., and O Connell, J.

PER CURIAM.

Plaintiff appeals as of right an order denying its motion for summary disposition and granting summary disposition in

favor of defendants pursuant to MCR 2.116(C)(10). We affirm in part and remand for further proceedings consistent with this opinion.

This is an oil and gas case. Plaintiff is the owner of mineral rights under lease to defendants. The sole issue on appeal concerns defendants rights to deduct post-production costs from plaintiff s royalty interests. This is the second time this post-production cost issue has been litigated in a Michigan court between these parties. In 1983, plaintiff s predecessor in interest litigated the same issue with defendants predecessors in interest.

In *North Michigan Land & Oil Corp v Shell Oil Co and Nielson v Shell Oil Co*, consolidated Crawford Circuit Court cases 80-004-292 CZ and 80-004-294, decided December 8, 1983, slip op at 15, 26-27, the court held that defendants predecessors in interest were entitled to deduct post-production costs from royalty payments. The plaintiffs in the consolidated cases appealed; however, before this Court issued an opinion, the parties agreed to settlements in favor of the plaintiffs. Thus, because these settlements prohibited the defendants from making the deductions, the settlements reached a result opposite from the trial court s original ruling.

The current litigation began when defendants, in contravention of the settlement agreement, began deducting post-production costs from plaintiff s royalty interests. In cross-motions for summary disposition, the parties set forth arguments interpreting the lease contract in their favor and discussing the precedence of the trial court s previous ruling in this matter. In May 2000, the lower court held in favor of defendants, citing the trial court s 1983 decision, but permitting plaintiff to file an amending complaint. In the amended complaint, plaintiff alleged that defendants committed breach of contract in failing to adhere to the 1984 and 1985 stipulated

settlements concerning post-production costs. However, the present parties then stipulated to dismiss the amended complaint, and on January 23, 2001, the lower court entered an order consistent with its May 2000 order. Plaintiff then filed the instant appeal.

At issue in the present case is a contractual provision stating that _[t]he lessee shall pay lessor, as royalty, one-eighth of the proceeds from the sale of the gas, as such, produced from gas wells on leased premises. The trial court held that this language unambiguously entitled defendants to deduct post-production costs from their proceeds when computing plaintiff s royalties. We conclude that the court reached the correct result albeit for the wrong reasons. See *Norris v State Farm Fire & Casualty Co*, 229 Mich App 231, 240; 581 NW2d 746 (1998).

As the trial court acknowledged, this case was previously litigated and resulted in an order that, though appealed, was never overturned. Under these circumstances, it is abundantly clear that we must address the res judicata doctrine. The purposes of res judicata are to relieve parties of the cost and inconvenience of multiple lawsuits, to conserve judicial resources, and to preserve the precedence of previous adjudications. *Pierson Sand & Gravel, Inc v Keeler Brass Co*, 460 Mich 372, 380; 596 NW2d 153 (1999). Applying the elements of res judicata to this case, first, the previous action was decided on the merits, and a final decision was reached. The fact that the previous litigation ultimately settled after the trial court s final order was issued does not preclude the order s res judicata effect. See *Ditmore v Michalik*, 244 Mich App 569, 576; 625 NW2d 462 (2001) (O Connell, P.J.).[1] Second, the

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[1]We note that because the stipulated settlements in the previous litigation were not consent judgments, i.e., signed

previous action involved the predecessors in interest of the parties to the instant litigation. See *id.* at 577. Thus, the predecessors are privies of the instant parties and the instant parties are bound by their predecessors actions. *Id.* At 578, n 2; see also *Wildfong v Fireman s Fund Ins Co*, 181 Mich App 110, 114-115; 448 NW2d 722 (1989); *Howell v Vito s Trucking & Excavating Co*, 386 Mich 37, 43; 191 NW2d 313 (1971).

Third, the over-arching issue in this case —© namely, whether post-production costs were deductible from royalties under the terms of the lease agreement —© was resolved in the previous litigation. Accordingly, all th elements of res judicata are met. See *Bd of Co Rd Commr s for Co of Eaton v Schultz*, 205 Mich App 371, 375-376; 521 NW2d 847 (1994); see also *Baraga Co v State Tax Comm*, 243 Mich App 452, 455-456; 622 NW2d 109 (2000), rev d on other grounds 466 Mich 264 (2002). Therefore, the trial court should have concluded that summary disposition was appropriate under MCR 2.116(C)(7) because the parties had previously litigated this matter in *North Michigan*. Though the trial court gave a different explanation for its decision, our conclusion merely provides an alternative ground for affirming. See *Messenger v Ingham Co Prosecutor*, 232 Mich App 633, 643; 591 NW2d 393 (1998).

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by the circuit court, the settlements themselves do not constitute res judicata in the case at bar. See Black s Law Dictionary (7th ed) (definitions of —agreed [consent] judgment, —settlement, and —stipulation); *Ditmore, supra*, citing *Baraga Co v State Tax Comm*, 243 Mich App 452, 455; 622 NW2d 109 (2000), and *Schwartz v Flint*, 187 Mich App 191, 194; 466 NW2d 357 (1991) (res judicata applies to consent judgments).

In addition, we note our agreement with the court below that plaintiff may be charged a portion of the severance tax as well as a portion of the privilege fee. The severance tax act, MCL 205.301 *et seq*., was amended in 1965 to expressly add royalty owners to those producers liable for the tax, MCL 205.312; *Brown v Shell Oil Co*, 128 Mich App 111, 116, 119; 339 NW2d 709 (1983), and royalty owners are subject to the tax regardless whether they are actually engaged in the business of severing oil and gas from the soil. See *Brown, supra* at 119; *Lawnichak v Treasury Dep t*, 214 Mich App 618, 622-623; 543 NW2d 359 (1995). Because the supervisor of wells act incorporated the provisions of the severance tax act, see MCL 324.61524, it follows that plaintiff may also properly be charged a portion of the privilege fee assessed under the supervisor of wells act.

Finally, we note that an important aspect of this case is that the lease was drafted in 1968. Currently, oil and gas producers and lessors use _division orders to indicate who receives royalties and in what amount. See *Condra v Quinoco Petroleum, Inc*, 954 SW2d 68, 70 (Tex Civ App 1997). _A division order is [a] contract of sale to the purchaser of oil or gas. The order directs the purchaser to make payment for the value of the products taken in the proportions set out in the division order. Williams & Meyers, Manual of Oil and Gas Terms 258 (1985). *Anadarko Petroleum Co v Venable,* 312 Ark 330, 338; 850 SW2d 302 (1993). A division order is intended to assure that the purchaser pays only those parties who are entitled to payment. *Blausey v Stein*, 61 Ohio St 2d 264, 267; 400 NE2d 408 (1980). _By signing the division order, the lessor is simply verifying that he has a right to royalty payments. *Id*

The record in this case does not indicate whether the parties proposed or signed a division order. Thus, we remand this case for a determination of whether the parties proposed or

signed a division order governing the disputed issues. If the parties did sign a division order, they are bound by is terms under ordinary contract principles. See *Terrien v Zwit*, 467 Mich 56, 71-72; 648 NW2d 602 (2002) (theory of freedom of contract binds parties to plain language of contract).

At oral argument in this case, plaintiff asserted that the original trial court s decision did not address all post-production costs the present defendants seek to deduct from plaintiff s royalties. In *North Michigan, supra*, slip op 5-10, 15, 26-27, the court only held that the parties must _apportion the costs of dehydration, treatment, . . . compression, and marketing costs between them. The disputed post-production costs raised in the court below and argued on appeal are: treatment for carbon dioxide removal; transportation to the point of sale; severance taxes; fuel loop costs; _miscellaneous charges (Plaintiff s Complaint, p 5); privilege fees; saltwater disposal and related operations; and costs incurred in gathering, separating, dehydrating, and compressing gas (Plaintiff s Brief in Support of Motion for Summary Disposition, p 4). The trial court in the present case ruled on the following types of costs: _post-production costs necessary to render the raw product marketable and saleable as gas, including severance taxes and privilege fees; and costs incurred in saltwater disposal and gathering, separating, dehydrating, and compressing gas. Trial Court Order, pp 3-4.

To the extent that the lower court did not address all issues that the parties properly raised below, and with regard to issues left unresolved by the trial court s decision in *North Michigan, supra,* we remand for a determination of these issues. See generally *Newark Morning Ledger Co v Saginaw Co Sheriff*, 204 Mich App 215, 224; 514 NW2d 213 (1994) (remand required for insufficient factual findings). We note that any issues that could have been raised but were not raised in the

1983 action are barred under the doctrine of res judicata. *Dart v Dart*, 460 Mich 573, 586-587; 597 NW2d 82 (1999).

Affirmed in part and remanded for further proceedings consistent with this opinion. We do not retain jurisdiction.

/s/ Harold Hood
/s/ Peter D. O Connell

STATE OF MICHIGAN

COURT OF APPEALS

SHR LIMITED PARTNERSHIP,

Plaintiff/Counter Defendant-Appellant,

v

MERCURY EXPLORATION COMPANY,

DOMINION RESERVES, INC., and QUICKSILVER RESOURCES, INC.,

Defendants/Counter Plaintiffs-Appellees.

UNPUBLISHED
December 6, 2002

No. 232466

Otsego Circuit Court
LC No. 99-008060-CK

Before: Hood, P.J., and Whitbeck, C.J., and O Connell, J.

WHITBECK, C.J. (*concurring in part and dissenting in part*)

I concur in the majority s conclusion that res judicata bars the parties from relitigating whether defendants can apportion post-production costs associated with making gas marketable even though the parties have not presented this as a ground for affirming. Regardless of whether the original decision and order permitting apportionment was correct or incorrect, it was never overturned. Thus, it thus remains binding on the original parties, and, now, their privies.

I respectfully dissent from the remainder of the majority s opinion. The parties in this action have not directly presented us with issues discussing the diverse subjects the opinion mentions in passing.[2] Nor have they graced us with adequate briefing that is so necessary to understand fully their positions on these matters, even though this Court usually counts briefing as a prerequisite for addressing for addressing an issue.[3]

Without a doubt, this case has some complexity to it. However, this Court has several clear alternatives for resolving the issues. If there are facts left to be found, then this Court should remand to the trial court for an evidentiary hearing, *retain* jurisdiction, and subsequently decide the remainder of the appeal on the basis of the supplemented record. If there are issues that the parties must develop in order for this Court to know how their positions, such as whether they need a division order in order, then this Court should ask the parties to brief the issue, state the relief they are requesting, and then decide the appeal in its entirety. If there are parts of the trial court s decision that fit poorly with the issues presented, but with which this Court agrees, this Court should integrate its views on these subjects in its analysis. If it is impossible for the Court to integrate its views on these subjects in a way that is meaningful for the parties, then it should make it clear that its broad observations do not require any particular action.

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[2]See MCR 7.212(C)(5).

[3]See *Shanafelt v Allstate Ins Co*, 217 Mich App 625, 643; 552 NW2d 671 (1996).

The majority opinion does not take this approach. Rather, I fear, the majority opinion takes a knotted ball of twine and simply tosses it back to the trial court to unwind. This is not an approach I can endorse, and I respectfully dissent as to those issues.

/s/ William C. Whitbeck

APPENDIX B

Court of Appeals, State of Michigan

ORDER

Harold Hood
Presiding Judge

SHR Limited Partnership v
Mercury Exploration Co

William C. Whitbeck, CJ

Peter D. O Connell
Judges

Docket No. 232466

LC No. 99-008060-CK

The Court orders that the motion for rehearing is DENIED.

Whitbeck, C.J., would GRANT rehearing.

A true copy entered and certified by Sandra Schultz Mengel, Chief Clerk, on

January 16, 2003 /s/_____
Chief Clerk

APPENDIX C

Order

Entered: October 31, 2003

Michigan Supreme Court
Lansing, Michigan

123214

Maura D. Corrigan,
Chief Justice
Michael F. Cavanagh
Elizabeth A. Weaver
Marilyn Kelly
Clifford W. Taylor
Robert P. Young, Jr.
Stephen J. Markman,
Justices

SHR LIMITED PARTNERSHIP,
Plaintiff/Counter Defendant-Appellant,

v

SC: 123214
COA: 232466
Otsego CC: 99-008060-CK

MERCURY EXPLORATION COMPANY, DOMINION RESERVES, INC., and QUICKSILVER RESOURCES, INC.,
Defendants/Counter Plaintiffs-Appellees.

_____/

On order of the Court, the application for leave to appeal the December 6, 2002 judgment of the Court of Appeals is considered, and it is DENIED, because we are not persuaded that the questions presented should be reviewed by this Court.

I, CORBIN R.DAVIS, Clerk of the Michigan Supreme Court, certify that the foregoing is a true and complete copy of the order entered at the direction of the Court.

July 28, 2003 /s/_____
Corbin R. Davis

APPENDIX D

Order

Entered: October 31, 2003

Michigan Supreme Court
Lansing, Michigan

123214

Maura D. Corrigan,
Chief Justice
Michael F. Cavanagh
Elizabeth A. Weaver
Marilyn Kelly
Clifford W. Taylor
Robert P. Young, Jr.
Stephen J. Markman,
Justices

SHR LIMITED PARTNERSHIP,
Plaintiff/Counter Defendant-Appellant,

v

SC: 123214
COA: 232466
Otsego CC:
99-008060-CK

MERCURY EXPLORATION COMPANY, DOMINION RESERVES, INC., and QUICKSILVER RESOURCES, INC.,
Defendants/Counter Plaintiffs-Appellees.

/

On order of the Court, the motion for reconsideration of this Court s order of July 28, 2003 is considered, and it is DENIED, because it does not appear that the order was entered erroneously. The motion for extension of time to file briefs *amicus curiae* is DENIED as moot.

I, CORBIN R.DAVIS, Clerk of the Michigan Supreme Court, certify that the foregoing is a true and complete copy of the order entered at the direction of the Court.

October 31, 2003 /s/_____
Corbin R. Davis

APPENDIX E

IN THE COURT OF APPEALS OF THE STATE OF MICHIGAN, on the first day of March in the year of our Lord one thousand nine hundred and eighty five.

Docket No. 77304 & 77305
L.C. No. 80-004-292 CZ
& 80-004-294 CZ

NORTH MICHIGAN LAND & OIL CORPORATION,

Plaintiff-Appellant,

v

SHELL OIL COMPANY,

Defendant-Appellee.

MELVIN K. NIELSON, ERNEST S. CORNWALL, and ELLA H. BRAUN, TRUSTEES OF SALLING HANSON COMPANY,

Plaintiffs-Appellants,

v

SHELL OIL COMPANY,
(Now Shell Western E&P, Inc.)

Defendant-Appellee.

In this cause is a stipulation agreeing to the dismissal of the appeal having been filed, by action of the Chief Clerk under the authority of GCR 1963, 809, the appeal is DISMISSED with prejudice and without costs.

STATE OF MICHIGAN ss.

I, Ronald L. Dzierbicki, Clerk of the Court of Appeals of the State of Michigan, do hereby certify that the foregoing is a true and correct copy of an order entered in said court in said cause; that I have compared the same with the original, and that is a true transcript therefrom, and the whole of said original order.

SEAL

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the seal of said Court of Appeals at Lansing, this 1st day of March in the year of our Lord one thousand nine hundred and eighty five.

/s/_____

APPENDIX F

STATE OF MICHIGAN

IN THE COURT OF APPEALS

SHR LIMITED PARTNERSHIP,
a West Virginia limited partnership,

Plaintiff-Appellant and
Counter-Defendant-Appellant,

Court of Appeals
Docket No. 232466

Otsego County
Circuit Court Case No.
99-8060 CK(D)

v

MERCURY EXPLORATION CO.,
a Texas corporation,
and
DOMINION RESERVES, INC.,
a Michigan corporaiton,
and
QUICKSILVER RESOURCES, INC.,
a Delaware corporation,

Defendants-Appellees,

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MOTION FOR REHEARING AND ARGUMENT IN SUPPORT

Plaintiff-Appellant moves for rehearing of this Court s Per Curiam opinion dated December 6, 2002 pursuant to MCR 7.215(H) and MCR 2.119(F). This Court relied upon the doctrine of *res judicata* which Defendants did not plead as an affirmative defense, did not argue in the circuit court and did not raise during the course of this appeal. This Court s decision contravenes the Michigan Court Rules, specifically MCR 2.111(F), which requires that affirmative defenses are waived if not asserted by prior motion or in the required responsive pleading. By addressing an issue not properly before it, this Court made its decision without knowledge of material facts and without benefit of the parties presentation of the relevant law. As such, this Court committed palpable error, which, if corrected, would require a different result.

FACTS

Plaintiff SHR Limited Partnership (hereinafter SHR) owns mineral interests in Otsego and Crawford counties which were previously leased to Shell Oil Company by Plaintiff s predecessors in interest. **(Plaintiff-Appellant s**

BOA Exhibits 1--4.) Defendants first acquired their interests in the mineral leases in a series of assignments beginning in 1991. **(Plaintiff-Appellant s BOA Exhibits 5--8.)** Thirty-two wells were drilled by Defendants after Defendant Mercury Exploration Co. (hereinafter Mercury) first acquired its interests via a 1991 _farm out agreement from Shell s subsidiary Shell Western E&P, Inc. **(Plaintiff-Appellant s BOA Exhibit 5.)** This litigation was limited to the 32 wells, any replacement wells and any future wells drilled on specified lands subject to the three leases between the parties. **(Plaintiff-Appellant s BOA Exhibit 9.)**

Mercury began producing and selling gas from the Antrim shale in 1992 but did not pay royalties owed to Plaintiff SHR until September 1997 when it tendered a check purporting to be for royalties accruing since 1992. **(BOA Exhibit 10.)** In computing the royalty paid to Plaintiff, Defendant Mercury deducted certain gas processing costs, including treatment of gas for CO2 removal, transportation on third party pipelines to the point of sale and _fuel loop costs , as well as a portion of the oil and gas severance tax and the Supervisor of Wells privilege fee. **(BOA Exhibit 11.)** In November 1999, Defendants began making additional deductions from Plaintiff s royalties which it referred to as _post production costs or _PPCs , specifically consisting of costs for gathering, separating, dehydrating or compressing the gas, and saltwater disposal and related operations. **(BOA Exhibits 11_15.)** (See March 10, 2000 Hearing Tr, p 46.)

Plaintiff brought suit in March 1999 challenging the propriety of Defendants deductions of the various costs, taxes and fees. With their initial Answer to Complaint, Affirmative Defenses and Counterclaim, Defendants did not include an affirmative defense based on the doctrine of *res*

judicata. **(Motion Appendix A.)** Within 14 days of filing their initial Answer and Affirmative Defenses, Defendants filed a First Amended Answer to Complaint, Affirmative Defenses and Counterclaim. Defendants did not plead *res judicata* as an affirmative defense. **(Motion Appendix Exhibit B.)** In responding to Plaintiff s discovery requests concerning the factual bases for their affirmative defenses, Defendants never raised the defense of *res judicata.* **(Motion Appendix C, #55 and D, #54.)**

The parties filed cross motions for summary disposition. Defendants motion for summary disposition and brief in support did not include any defense based on *res judicata.* Defendants did not raise a *res judicata* defense during oral arguments on the motions. The circuit court did not address any defense of *res judicata.*

By its Order Regarding Cross-Motions for Summary Disposition, dated May 12, 2000, the circuit court granted Defendants motion for summary disposition on Plaintiff s complaint and on Count I of Defendants counterclaim, finding that the leases permitted the deduction of post-production costs necessary to render the raw product marketable and saleable as gas and that the severance tax and the supervisor of wells acts require royalty owners on oil and gas leases to pay their proportionate share of the severance taxes and privilege fees.

This Court affirmed the circuit court s decision that Defendants could deduct post-production costs, not for the reasons given by the circuit court, or an analysis of the issues, but rather only on grounds of *res judicata,* an affirmative defense neither pleaded nor argued by Defendants. It also affirmed the circuit court s decision regarding the severance tax and privilege fee. Citing law from foreign jurisdictions,

this Court also raised an issue concerning whether division orders had ever been proposed or signed in this case and remanded for a determination of whether the parties had proposed or signed a division order. This issue was never raised by the parties.

This Court based its *res judicata* ruling on a 1983 decision of the Crawford County Circuit Court Judge Porter in two consolidated cases[4]. Judge Porter s decision dealt with whether Shell Oil Company could apportion to the plaintiff lessors in those actions a share of the of treatment, dehydration and compression costs for production from eight oil wells and one gas well drilled by Shell in the early 1970s.[5] **(BOA Attachment 1, p 3.)** The plaintiffs appealed and after oral argument in the Court of Appeals, the parties entered a stipulation for settlement **(BOA Exhibit 17)** in which Shell Oil Company and Shell Western E&P, Inc. agreed to pay royalties consistent with a stipulation for settlement entered in *Brown v Shell.*[6] **(BOA Exhibit 18.)** The *Brown* stipulation for settlement did not authorize deduction of any costs from royalties.

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[4] *North Michigan Land & Oil Corporation v Shell Oil Company*, Crawford County Circuit Court Case No. 80-004-292 CZ and *Melvin K. Nielson v Shell Oil Company,* Crawford County Circuit Court Case No. 80-004-294. **(BOA Attachment 1.)**

[5] The wells that are the subject of the instant case were not drilled until the 1990s.

[6] Grand Traverse County Circuit Court Case No 81-0050-CK.

ARGUMENT
I

THE COURT OF APPEALS COMMITTED PALPABLE ERROR BY GRANTING SUMMARY DISPOSITION TO DEFENDANTS BASED ON AN AFFIRMATIVE DEFENSE THEY HAD WAIVED BY FAILING TO PLEAD OR RAISE IN ANY MANNER.

The Michigan Court Rules require that defenses not asserted in the responsive pleading or by motion are waived.

> Under MCR 2.111(F)(3), affirmative defenses must be raised in the responsive pleading, unless they previously have been raised in a motion for summary disposition before the filing of a responsive pleading, MCR 2.111(F)(2)(a). The failure to raise an affirmative defense as required by the court rule constitutes a waiver of that affirmative defense.

Stanke v State Farm Ins, 200 Mich App 307, 312; 503 NW2d 758 (1993), citing *Campbell v St John Hosp,* 434 Mich 608, 616; 455; 455 NW2d 695 (1990). MCR 2.111(F) provides in relevant part:

> (2) *Defenses Must Be Pleaded; Exceptions.* **A party** against whom a cause of action has been asserted by complaint, cross-claim, counterclaim, or third-party claim **must assert in a responsive pleading the defenses**

> **the party has against the claim. A defense not asserted in the responsive pleading or by motion as provided by these rules is waived,** except for the defenses of lack of jurisdiction over the subject matter of the action, and failure to state a claim on which relief can be granted. . . . (Emphasis added)

MCR 2.111(F) also sets stringent time requirements for pleading affirmative defenses:

> (3) *Affirmative Defenses.* Affirmative defenses must be stated in a party s responsive pleading, either as originally filed or as amended in accordance with MCR 2.118. Under a separate and distinct heading, a party must state the facts constituting
>
> (a) an affirmative defense, such as contributory negligence; the existence of an agreement to arbitrate; assumption of risk; payment; release; satisfaction; discharge; license; fraud; duress; estoppel; statute of frauds; statute of limitations; immunity granted by law; want or failure of consideration; or that an instrument or transaction is void, voidable, or cannot be recovered on by reason of statute or nondelivery;
>
> (b) a defense that by reason of other affirmative matter seeks to avoid the legal effect of or defeat the claim of the opposing party, in while or in part;

> (c) a ground of defense that, if not raised in the pleading, would be likely to take the adverse party by surprise. (Emphasis added.)

Defendants have not raised *res judicata* at any time in this case, constituting a waiver of this defense. *Head v Benj Rich Realty Co,* 55 Mich App 348; 237 NW2d 237 (1974). Yet, this Court interjected the defense on its own volition, ignoring the clear requirements of MCR 2.111 and the strict adherence to its requirements by other panels of this Court. See *Grzesick* v *Cepela*, 237 Mich App 554; 603 NW2d 809 (2000), wherein the Court of Appeals affirmed the trial court s ruling that pursuant to MCR 2.111(F)(3) defendant waived the affirmative defense of comparative negligence by failing to plead it in the second amended answer to plaintiff s countercomplaint.

Nothing about the defense of *res judicata* requires or allows this Court to ignore the mandate of MCR 2.111(F). As the Supreme Court noted in *Pierson Sand Gravel, Inc. v Keeler Brass Co,* 460 Mich 372, 382-383; 596 NW2d 153 (1999),

> We must remember that this doctrine [*res judicata*] is not a constitutional mandate that must be carefully construed to maintain its integrity, but only a tool created by the courts. . . .The goal of *res judicata* is to promote fairness, not lighten the loads of the state court by precluding suits whenever possible.

The Court should not have interjected the defense of *res judicata.* It was not raised below. It was not even raised prior to oral argument in the Court of Appeals. *Napier v*

Jacobs, 429 Mich 222, 237-238; 414 NW2d 862 (1987); *Cremonte v Michigan State Police*, 232 Mich App 240; 591 NW2d 261 (1998). This Court committed palpable error by basing its ruling on the defense of res judicata which it alone asserted, ignoring the requirement that the Defendant had the burden of proving that defense. *E & G Finance Co. v Simms* 362 Mich 592; 107 NW 2d 911 (1961).

II

AN ISSUE OF LAW DECIDED IN A PRIOR LAWSUIT SHOULD NOT BAR LITIGATION OF THAT ISSUE IN THE PRESENT CASE WHERE THE PARTIES IN THE EARLIER CASE ARE NO LONGER BOUND BY THE DECISION.

This Court ruled that a 1983 Crawford County Circuit Court decision allowing the defendant, Shell Oil Company, to deduct a portion of certain post-production costs from oil and gas royalties barred consideration of that issue in the instant case. In so holding this Court stated:

> Applying the elements of *res judicata* to this case, first, the previous action was decided on the merits, and a final decision was reached. The fact that the previous litigation ultimately settled after the trial court s final order was issued does not preclude the order s *res judicata* effect. See *Ditmore v Michalik,* 244 Mich App 569, 576; 625 NW2d 462 (2001).

This Court s reliance on *Ditmore v Michalik, supra,* is misplaced. *Ditmore* did not address the issue of whether settlement after a final order is entered should preclude the order s *res judicata* effect where the settlement effectively

resolves the legal issue contrary to how it was resolved in the final order. In *Ditmore*, a consent judgment was entered in earlier litigation involving certain rights and restrictions on lots in a subdivision. The only ruling in *Ditmore* concerning _settlement was the Court of Appeals observation that *res judicata* applies to consent judgments.

Res judicata does not bar re-litigation of an issue of law where a new determination is warranted in order to take account of intervening changes in the law or to avoid inequitable administration of the laws. *Juncaj v C&H Industries*, 161 Mich App 724, 732; 411 NW2d 839 (1987), *affm* 431 Mich 632; 433 NW2d 787 (1988); *Socialists v Sec of State,* 412 Mich 571, 584; 317 NW2d 1 (1982); *Young* v *Detroit City Clerk*, 389 Mich 333,339; 207 NW2d 126 (1973). The interpretation of the royalty clause of the leases was solely an issue of law for the court to decide. *G&A Inc v Nahra,* 204 Mich App 329; 514 NW2d 255 (1994). Judge Porter s decision interpreting the royalty clause should not bar Plaintiff s claim.

The parties who actually litigated the issue before Judge Porter repudiated his decision in their Stipulation for Settlement entered in the Court of Appeals. Additionally, at the time of Judge Porter s decision, there was no Michigan case interpreting a royalty clause calling for payment of royalty on _proceeds from the sale of the gas . This Court s subsequent decision in *Schroeder v Terra Energy*, 223 Mich App 175; 565 NW2d 887 (1997), while interpreting an _at the well royalty clause as opposed to a _proceeds royalty clause, does shed light on the proper interpretation of a _proceeds royalty clause. In construing an _at the well clause, the Court of Appeals stated in *Schroeder,* at 187:

> The [t]erm _at the well is used as a way to allocate refining and transportation costs between the lessor and lessee. _At the well refers to proceeds minus refining and transportation costs, as opposed to proceeds at the point of sale, where refining and transportation costs are not deducted.

Thus, under the *Schroeder* analysis, if the royalty clause lacks the _at the well language, as herein, there is nothing authorizing the lessee to deduct such costs from lessor s royalties.

The Supreme Court in *Pierson, supra,* viewed *res judicata* as a doctrine to promote fairness. This Court s application of a *res judicata* defense is particularly unfair under the circumstances of this case. The 1983 final order entered in the Crawford County cases is no longer enforceable against the parties in those cases because the parties by their Stipulation for Settlement in the Court of Appeals entered a contractual agreement to not abide by the order. If those parties in the earlier action retain any of their interests under the leases in question, they can enjoy receiving royalties from which no post production costs are deducted, while Plaintiff receives reduced royalties under the same leases. Further, the oil and gas leases at issue were based on Shell Oil Company s form lease which undoubtedly continues in widespread use in Michigan. With the exception of Plaintiff, parties to identical Shell leases are free to challenge whether their lessees can deduct post-production costs under the terms of the identical royalty clause.

III

THE COURT OF APPEALS COMMITTED PALPABLE ERROR BY NOT AFFORDING PLAINTIFF THE OPPORTUNITY TO CHALLENGE THE COURT S *SUA SPONTE* APPLICATION OF RES JUDICATA.

The Court committed palpable error by interjecting the defense of *res judicata*, and concluding that the defense was determinative without affording the Plaintiff the opportunity to challenge its application depriving the Plaintiff of procedural due process. The practical effect of this Court s decision is to deprive the Plaintiff of property rights without affording it at any time the opportunity to be heard. See *Brinkerhoff - Faris Trust & Savings Co. V. Hills,* 281 US 673; 50S.Ct. 451; 74 L Ed 1107 (1930) *Res judicata* is not the result of a legislated mandate requiring the bar be imposed without regard to the surrounding circumstances, nor even a common law rule. It is only a Court made doctrine created to _relieve parties of the cost and vexation of multiple lawsuits, conserve judicial resources, and, by preventing inconsistent decisions, encourage reliance on adjudication. *Allen v. McCurry*, 449 US 90, 94; 101 S Ct 411; 66 L Ed 2d 308 (1980). The central goal of the doctrine s application is to _free people from the uncertain prospect of litigation, with all its costs to emotional peace and the ordering of future affairs. 18 Wright , Miller & Cooper, Federal Practice and Procedure Sec 4403 , p15.

The manner in which the defense was inserted by this Court not only did not afford Plaintiff the elemental due process right to address the issue, but also, included no analysis of the surrounding circumstances to determine

whether the policy of the doctrine was consistent with the facts of this case. There has been no showing nor has there been any determination of factual background including any hardship on Defendant to justify imposing the bar.

IV

THE COURT COMMITTED PALPABLE ERROR BY SUGGESTING THAT DIVISION ORDERS, RATHER THAN THE LEASE, WOULD CONTROL THE PAYMENT OF ROYALTIES AND REMANDING FOR A DETERMINATION OF WHETHER THE PARTIES EVER SIGNED DIVISION ORDERS.

Until this Court issued its Opinion, it has never been suggested at any time in this case that division orders were signed or if they were that such orders would control how royalties are to be calculated.[7] This Court cited decisions from the Texas, Arkansas and Ohio in introducing this entirely new issue. There is no law in Michigan that remotely suggests that a division order can change the terms of a royalty clause of an oil and gas lease. Moreover, the Attorney General has opined , The agreement between the Lessor and Lessee is contained in the lease and determines the various liabilities. A lease is not affected by the Division Order. Op. Atty. Gen. 1963-64, No. 4160, p. 120. It was error for this Court to even broach the subject.

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[7] [W]e note that an important aspect of this case is that the lease was drafted in 1968. Currently, oil and gas producers and lessors use division orders to indicate who receives royalties and in what amount. Page 3 of this Court s Opinion.

CONCLUSION AND REQUEST FOR RELIEF

Based on the foregoing, this Court is requested to grant rehearing, reverse the Judgment of the Circuit Court and enter Judgment in favor of Plaintiff.

Respectfully submitted,

Dated: December 20, 2002 ROSI LAW OFFICES, P.C.

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APPENDIX G

STATE OF MICHIGAN
IN THE SUPREME COURT

SHR LIMITED PARTNERSHIP,
a West Virginia limited partnership,

Plaintiff-Appellant and
Counter-Defendant-Appellant,

v

MERCURY EXPLORATION CO.,
a Texas corporation,
and
DOMINION RESERVES, INC.,
a Michigan corporation,
and
QUICKSILVER RESOURCES, INC.,
a Delaware corporation,

Defendants-Appellees,

Supreme Court Case No._____
Court of Appeals Case No. 232466
Otsego County Circuit Court Case No. 99-8060-CK(D)

Philip R. Rosi (P31915) Rosi & Gardner, P.C. Attorneys for Plaintiff-Appellant 735 S. Garfield, Suite 202 Traverse City, MI 49684 (231) 941-5878	James R. Neal (P24265) Gary L. Field (P37270) Attorneys for Defendant-Appellee 232 S. Capitol Ave., Ste. 1000 Lansing, MI 48933-1525 (517) 482-2400

PLAINTIFF-APPELLANT S APPLICATION FOR LEAVE TO APPEAL

Respectfully submitted,

ROSI & GARDNER, P.C.

Date: February ___, 2003 By: /s/_____

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STATEMENT OF JUDGMENT APPEALED FROM AND RELIEF SOUGHT

Appellant SHR Limited Partnership seeks leave to appeal the decision of the Court of Appeals in *SHR Limited Partnership v Mercury Exploration Co., Dominion Reserves, Inc. and Quicksilver Resources, Inc.*, unpublished *per curiam* opinion of the Court of Appeals, decided December 6, 2002 (Docket No. 232466). **(Attachment A)** Appellant-Plaintiff is the lessor under oil and gas leases that provide for royalties on gas of ___. . . one-eighth of the proceeds from the sale of gas, oil as such, produced from gas wells on the leased premises. Plaintiff s suit challenged the propriety of Defendants deduction of a portion of expenses they incurred after gas was extracted from the ground, so-called post production costs, from Plaintiff s gas royalties. Plaintiff also challenged Defendants deduction, from Plaintiff s gas royalties, of a pro-rata portion of the severance taxes and privilege fees paid by Defendants because the leases included no authority for such deductions. The Otsego County Circuit Court rejected Plaintiff s challenge, granting Defendants summary disposition and ruling that each lease, as a ___proceeds lease, had

the same meaning as a _well head lease. It also ruled that the deduction of a share of severance taxes and privilege fees from royalties was allowable.

The Circuit Court decided that the royalty provision of the oil and gas lease permitted Defendants to deduct post-production costs _necessary to render the raw product marketable and saleable as gas and that the severance tax and supervisor of wells acts require royalty owners on oil and gas leases to pay their proportionate share of the severance taxes and privilege fees.[8]

The Court of Appeals majority decision affirmed in part the Otsego County Circuit Court s January 23, 2001 judgment **(Attachment C)** granting summary disposition for Defendants, basing its decision on grounds *not* addressed by the circuit court *or* raised by the parties in either the Circuit Court or the Court of Appeals. It also affirmed the decision of the Circuit Court regarding the obligation of Plaintiff to bear a portion of taxes and fees the State imposed upon Defendants. The Court of Appeals also remanded the case for a determination of other issues not addressed by the Circuit Court, including one issue not raised by the parties.

In an unprecedented decision, the Court of Appeals affirmed the Circuit Court s decision that Defendants could deduct post-production costs, not for the reasons given by the Circuit Court, but on grounds of *res judicata,* an affirmative defense not pled by Defendants and not briefed or argued by any of the parties in the Circuit Court or the Court of Appeals. In addition to being clearly erroneous and materially unjust, the Court of Appeals decision raises issues involving legal principles of major significance to the State s jurisprudence. Briefly, these

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[8] Otsego County Circuit Court Judge Alton D. Davis Order Regarding Cross-Motions for Summary Disposition, dated May 12, 2000 is attached as **Attachment B.**

issues are: 1) should the Court of Appeals have interjected, *sua sponte,* (for the benefit of Defendant) the defense of *res judicata,* a defense not raised by Defendant, ignoring the mandate of MCR 2.111(F) and prior decisions of this Court and the Court of Appeals holding that unless the affirmative defense is properly and timely raised, it is waived; 2) in affirming the decision of the Circuit Court through the interjection of the *res judicata* defense, should the Court of Appeals have remanded the matter to the Circuit Court for further findings of historical matters beyond the reach of either Plaintiff or Defendants with no guidance as to who has the burden of producing such evidence; 3) should not the Court of Appeals have conducted a *de novo* review of the merits of Plaintiffs contention that under the lease at issue it has no obligation to bear any portion of the costs incurred by Defendant in connection with gas produced, after the gas was removed from the ground, and; 4) should not the Court of Appeals have conducted a *de novo* review of the merits of Plaintiff s contention that it has no responsibility, by contract or by statute, to bear any share of taxes and fees imposed upon Defendants.

The Court of Appeals based its *res judicata* ruling on a 1983 decision of Crawford County Circuit Court Judge Porter in two consolidated cases.[9] Judge Porter s decision dealt with whether Shell Oil Company could apportion to the plaintiff lessors a share of the treatment, dehydration and compression costs for production from eight oil wells and one gas well drilled by Shell in the early 1970s.[10] The Court of Appeals also affirmed the Circuit Court s decision that the severance tax and supervisor of wells acts allow Defendants to charge Plaintiff a portion of the severance taxes and privilege fees.

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[9] *North Michigan Land & Oil Corp v Shell Oil Co,* Crawford County Circuit Court Case No. 80-004-292 CZ and *Melvin K. Nielson, et al v Shell Oil Co,* Crawford County Circuit Court Case No. 80-004-294.

[10] See page 3 of Judge Porter s decision attached as Appendix Exhibit 17.

The basis for the Court of Appeals remand order was two-fold. On its own initiative, the Court of Appeals raised a question of whether division orders had ever been proposed or signed in this case. It remanded the case for a determination of that issue. The Court of Appeals contended, based on Texas, Ohio and Arkansas cases, that if division orders were signed, those orders, not the language of the oil and gas leases, would determine the amount of Plaintiff s royalties. This issue was never raised by the parties. The Court of Appeals also remanded this case to the Circuit Court for a determination by any issues raised in the instant action but not resolved by the 1983 decision of Judge Porter. The Court of Appeals contended that the 1983 decision dealt with the issues of costs for dehydration, treatment, compression and marketing. Judge Porter s decision shows that the only costs that were at issue and were decided by Judge Porter in that case were costs for dehydration, treatment and compression for gas produced from the existing one gas and eight oil wells sold to Michigan Consolidated Gas.[11]

Plaintiff timely filed a motion for rehearing on December 21, 2002, which was denied by the Court of Appeals on January 16, 2003. **(Attachment D)** Chief Judge Witbeck would have granted rehearing.

The Court of Appeals decision is clearly erroneous, materially unjust and conflicts with prior decisions of this Court and the Court of Appeals that held that affirmative defenses, including *res judicata*, if not timely and properly pled, are waived. *Campbell v St Johns Hospital,* 434 Mich 608, 455 NW2d 695 (1990); *Head v Benjamin Rich Realty Co,* 55 Mich App 348; 222 NW2d 237 (1974). Defendants never asserted *res judicata* as a defense. Consequently, there was no factual record to support the defense and no showing that Defendants could meet their

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[11] Pages 3, 4, 26 and 27 of Judge Porter s decision, Appendix Exhibit 17.

burden of proving the defense. There was nothing on the record showing the essential facts necessary to establish the defense, including no showing that the matters contested in the current case were or could have been decided in the prior case. The decision by former Crawford County Circuit Court Judge Porter which the Court of Appeals used to bar Plaintiff s claims herein dealt with nine wells that were both different in time and place, and technologically distinct from the 32 wells at issue herein. This matter deals with different causes of action than those in the prior action which dealt with limited cost issues specific to the circumstances of the nine wells that were the subject matter of that lawsuit. The instant action concerns 32 wells drilled years later.

The Court of Appeals ruling in *Schroeder v Terra Energy*, 223 Mich App 176; 565 NW2d 887 (1997) suggests that the basis for Judge Porter s ruling that the defendant in *North Michigan Land and Oil*[12] could deduct from royalties its costs of treatment, dehydration and compression of the gas was in error. *Res judicata* should not bar re-litigation of an issue of law where a new determination is warranted in order to take account of intervening changes in the law or to avoid inequitable administration of the laws. *Juncaj v C&H Industries,* 161 Mich App 724, 732; 411 NW2d 839 (1987), *aff d* 431 Mich 632; 433 NW2d 787 (1988).

Defendants were aware of the 1983 decision by then Crawford County Circuit Court Judge Porter in *North Michigan Land & Oil Corp v Shell Oil Co* and *Nielson v Shell Oil Co* and even attached a copy of the decision as an exhibit to their reply to Plaintiff s motion for summary disposition. However, Defendants never pled the affirmative defense of *res judicata* and did not ask the Circuit Court for summary disposition based on a *res judicata* defense. Nor did Defendants raise this defense in the Court of Appeals. The first time the defense was raised was when

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[12]See N 2, supra.

one of the Court of Appeals judges asked Plaintiff s counsel, in oral argument, whether Plaintiffs claims were barred on the basis of this defense. Plaintiff s counsel responded that the defense had been waived and that the parties in the *North Michigan Land & Oil* and *Nielsen* cases had settled those matters in the Plaintiffs favor while an appeal was pending in the Court of Appeals, effectively nullifying the application of Judge Porter s decision to those parties. Despite there being no developed factual record to support the defense, the Court of Appeals decided, on its own initiative, that *res judicata* barred Plaintiff s claims.

In its affirmation of the Circuit Court s decision regarding the obligation of Plaintiff to bear a portion of the taxes and fees, the Court of Appeals asserted: _The severance tax act, MCL 205.301 *et seq,* was amended in 1965 to expressly add royalty owners to those producers liable for the tax, MCL 205.312; *Brown v Shell Oil Co*, 128 Mich App 111, 116, 119; 339 NW2d 709 (1983). The referenced statute, MCL 205.312, does not make reference to royalty owners. Rather, it provides a definition of producer. Without explanation, the Court of Appeals apparently concluded that a royalty owner is a producer under the statute, a position inconsistent with a prior decision of this Court. *Mobil Oil Corp* v *Dept of Treasury*, 422 Mich 473; 373 NW2d 730 (1985).

The Court of Appeals ignored the fact that nowhere within the text of 1965 severance tax act amendment is there any reference to royalty owners as being a party liable for the tax. Nor did the Court of Appeals explain the conclusion it reached that the severance tax act, which specifically imposed a tax upon _producers engaged in the business of severing from the soil, oil and gas MCL 205.301, is nonetheless an obligation of a royalty owner _regardless of whether they are actually engaged in the business of severing oil and gas from the soil. Then, without analysis and despite the absence of any reference to royalty owners within the supervisor of wells act, the Court of Appeals

concluded that a royalty owner may also be charged a portion of the privilege fee assessed under that act.

For the reasons more fully set forth below, Plaintiff respectfully requests that this Court grant leave to appeal, vacate the decision of the Court of Appeals, vacate the Judgment and Order Granting Summary Disposition of the Otsego County Circuit Court, grant summary disposition in Plaintiff s favor and remand to the Circuit Court for a determination of damages and entry of judgment for Plaintiff.

QUESTIONS PRESENTED FOR REVIEW

1. DID THE COURT OF APPEALS ERR BY ASSERTING FOR DEFENDANTS THE AFFIRMATIVE DEFENSE OF *RES JUDICATA* WHICH WAS NEVER PLED OR ARGUED BY DEFENDANTS AND, THEREFORE, WAIVED AND WHERE THERE WAS NO FACTUAL RECORD TO SUPPORT SUCH A DEFENSE HAD DEFENDANTS ASSERTED IT?

   The Court of Appeals presumably would answer: No.

   Plaintiff-Appellant answers: Yes.

   Defendants-Appellees would presumably answer: "No."

2. WHERE THE PRIOR ACTION DEALT WITH A DIFFERENT WELLS AND, THEREFORE, A DIFFERENT CAUSE OF

ACTION THAN THE INSTANT CASE WHICH CONCERNS 32 GAS WELLS DRILLED YEARS AFTER THE FIRST ACTION WAS DECIDED, DID THE COURT OF APPEALS ERR IN HOLDING THAT PLAINTIFF S CLAIMS HEREIN ARE BARRED ON GROUNDS OF *RES JUDICATA?*

The Court of Appeals presumably would answer: No.

Plaintiff-Appellant answers: Yes.

Defendants-Appellees would presumably answer: "No."

3. WHERE THE CIRCUIT COURT IN A PRIOR ACTION DECIDED AN ISSUE OF LAW WITHOUT BENEFIT OF MICHIGAN APPELLATE GUIDANCE AND A SUBSEQUENT COURT OF APPEALS DECISION SUGGESTS THAT THE DECISION ON THE LEGAL ISSUE IN THE EARLIER ACTION WAS ERRONEOUS, DID THE COURT OF APPEALS ERR IN RULING THAT *RES JUDICATA* BARS PLAINTIFF S CLAIMS HEREIN?

The Court of Appeals presumably would answer: No.

Plaintiff-Appellant answers: Yes.

Defendants-Appellees would presumably answer: "No."

4. DID THE COURT OF APPEALS COMMIT ERROR BY RAISING THE ISSUE OF DIVISION ORDERS ON ITS OWN INITIATIVE AND SUGGESTING THAT SUCH ORDERS, AS OPPOSED TO THE ROYALTY CLAUSE OF A LEASE, DETERMINE THE AMOUNT OF ROYALTIES TO BE PAID TO A LESSOR?

The Court of Appeals would answer: No.

Plaintiff-Appellant answers: Yes.

Defendants-Appellees would presumably answer: "No."

5. DID THE COURT OF APPEALS ERR IN AFFIRMING THE CIRCUIT COURT S RULING THAT THE SEVERANCE TAX ACT AND SUPERVISOR OF WELLS ACT REQUIRE ROYALTY OWNERS ON OIL AND GAS LEASES TO PAY A PROPORTIONATE SHARE OF THE SEVERANCE TAXES AND PRIVILEGE FEES IMPOSED ON DEFENDANTS?

The Court of Appeals would answer: No.

Plaintiff-Appellant answers: Yes.

Defendants-Appellees would presumably answer: "No."

6. DID THE CIRCUIT COURT ERR IN HOLDING THAT THE ROYALTY CLAUSE OF THE LEASES ALLOWS DEFENDANTS TO DEDUCT POST-PRODUCTION COSTS NECESSARY TO RENDER THE RAW PRODUCT MARKETABLE AND SALEABLE AS GAS?

The Court of Appeals did not answer the question.

Plaintiff-Appellant answers: Yes.

Defendants-Appellees would presumably answer: "No."

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CONCISE STATEMENT OF FACTS AND PROCEEDINGS

Plaintiff SHR Limited Partnership (_SHR) owns mineral interests in Otsego and Crawford counties which were previously leased to Shell Oil Company by SHR s predecessors in interest. **(Appendix Exhibits 1-4.)** Defendants first acquired their interests in the mineral leases in a series of assignments beginning in 1991. **(Appendix Exhibits 5-8.)** Thirty-two wells were drilled by Defendants after Defendant Mercury Exploration Co. (_Mercury) first acquired its interests via a 1991 _farm out agreement from Shell s subsidiary, Shell Western E&P, Inc. **(Appendix Exhibit 5.)** This litigation was limited, by stipulation of the parties, to the 32 wells, any replacement wells and any future wells drilled on specified lands subject to the three leases between the parties. **(Appendix Exhibit 9.)**

Mercury began producing and selling gas from the Antrim shale in 1992 but did not pay royalties owed to SHR until September 1997, when it tendered a check purporting to be for royalties accruing since 1992. **(Appendix Exhibit 10.)** In computing the royalty paid to Plaintiff, Defendant Mercury deducted certain gas processing costs, including treatment of gas for CO_2 removal, transportation on third party pipelines to the point of sale and _fuel loop costs, as well as a portion of the oil and gas severance tax and the Supervisor of Wells privilege fee. **(Appendix Exhibit 11.)** In November 1999, Defendants began making additional deductions from Plaintiff s royalties which it referred to as _post production costs (_PPCs), specifically consisting of costs for gathering, separating, dehydrating or compressing the gas, saltwater disposal and related operations. **(Appendix Exhibit 12, p 46.)**

Plaintiff brought suit in March 1999 contending that the royalty clause[1] of the three identical pre-printed oil and gas industry

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[1] The applicable royalty clause is found in paragraph 4 of the leases:

lease forms **(Appendix Exhibit 3)** did not authorize Defendants as lessees to deduct various post production costs, severance taxes or privilege fees from royalties. With their initial answer to the complaint, affirmative defenses and counterclaim, Defendants did not include an affirmative defense based on the doctrine of *res judicata.* **(Appendix Exhibit 13.)** Within 14 days of filing their initial Answer and Affirmative Defenses, Defendants filed a first amended answer to the complaint, affirmative defenses and counterclaim. Again, Defendants did not plead *res judicata* as an affirmative defense. **(Appendix Exhibit 14.)** In responding to Plaintiff s discovery requests concerning the factual bases for their affirmative defenses, Defendants never raised the defense of *res judicata.* **(Appendix Exhibits 15-16.)**

The parties filed cross motions for summary disposition. Defendants motion for summary disposition and brief in support did not include any theory or argument based on the defense of *res judicata.* Defendants did not raise a *res judicata* defense during oral arguments on the motions. The Circuit Court did not address any defense of *res judicata.*

By its May 12, 2000 Order Regarding Cross-Motions for Summary Disposition **(Attachment C)** the Circuit Court granted Defendants motion for summary disposition on Plaintiff s complaint and on count I of Defendants counterclaim, finding that the leases permitted the deduction of post-production costs necessary to render the raw product marketable and saleable as gas and that the severance tax and the supervisor of wells acts require royalty owners on oil and gas leases to pay their proportionate share of the severance taxes and privilege fees.

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4. The lessee shall pay lessor, as royalty, one-eighth of the proceeds from the sale of the gas, as such, produced from gas wells on leased premises . . .

Plaintiff brought a timely appeal. The Court of Appeals majority opinion **(Attachment A)** affirmed the Circuit Court s decision that Defendants could deduct post-production costs, not for the reasons given by the Circuit Court, but on grounds of *res judicata,* an affirmative defense not pled or argued by Defendants. The Court of Appeals also affirmed the Circuit Court s conclusion that Plaintiff, as an owner of royalty interest, was liable for a portion of Michigan s oil and gas severance tax and the privilege fee assessed by the supervisor of wells act.

The Court of Appeals then remanded this case to the Circuit Court for determination of certain factual issues that it raised on its own initiative. Citing law from foreign jurisdictions, the majority s decision contended that if division orders were signed by the parties, such orders would govern the amount of royalties owed, and remanded for a determination of whether division orders were signed. As part of the remand order, the majority decision also provided the following instructions for further determination of the post-production cost issue:

> To the extent that the lower court did not address all issues that the parties properly raised below, and with regard to issues left unresolved by the trial court s decision in *North Michigan, supra,* we remand for a determination of these issues. [Citation omitted] We note that any issues that could have been raised but were not raised in the 1983 action are barred under the doctrine of *res judicata.*[2]

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[2] See pages 3 and 4 of Court of Appeals majority decision.

The Court of Appeals based its *res judicata* ruling on a 1983 decision of the Crawford County Circuit Court Judge Porter **(Appendix Exhibit 17)** in two consolidated cases.[3] Judge Porter s decision dealt with whether Shell Oil Company could apportion to the plaintiff lessors a share of the of treatment, dehydration and compression costs for production from eight oil wells and one gas well drilled by Shell in the early 1970s.[4] **(Appendix Exhibit 17, p 3.)** The plaintiffs therein appealed and after oral argument in the Court of Appeals, the parties entered a stipulation for settlement **(Appendix Exhibit 18)** in which Shell Oil Company and Shell Western E&P, Inc. agreed to pay royalties consistent with a stipulation for settlement entered in 1984 in the *Brown v Shell* class action.[5] **(Appendix Exhibit 19.)** The *Brown* stipulation for settlement did not authorize deduction of any costs from royalties.

The defense of *res judicata* was not raised in the instant case until one member of the Court of Appeals panel hearing oral argument asked Plaintiff s counsel whether the defense applied. Plaintiff s counsel advised that *res judicata* was not pled and not raised at any time and therefore waived by Defendants. Plaintiff timely moved for rehearing in the Court of Appeals, attaching as exhibits Defendants pleadings and discovery responses demonstrating that the defense was never raised. **(Appendix Exhibits 13-16.)** The motion for rehearing was denied by order of

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[3] *North Michigan Land & Oil Corp v Shell Oil Co,* Crawford County Circuit Court Case No. 80-004-292 CZ and *Melvin K. Nielson v Shell Oil Co,* Crawford County Circuit Court Case No. 80-004-294

[4] The wells that are the subject of the instant case were gas wells drilled by Defendant Mercury in the 1990s.

[5] Grand Traverse County Circuit Court Case No 81-0050-CK.

January 16, 2003, with Chief Judge Whitbeck indicating he would grant rehearing. **(Attachment D.)**

ARGUMENT

I. STANDARD OF REVIEW

The Supreme Court reviews the determinations of the Court of Appeals on questions of law *de novo. Cardinal Mooney High School v Michigan High School Athletic Ass n,* 437 Mich 75, 80; 467 NW2d 21, 24 (1991). Questions of statutory interpretation are reviewed *de novo. In re MCI Telecommunications,* 460 Mich 396; 596 NW2d 164 (1999).

II. THE COURT OF APPEALS ERRED BY *SUA SPONTE* BARRING PLAINTIFF S CLAIMS BASED ON *RES JUDICATA,* AN AFFIRMATIVE DEFENSE WHICH DEFENDANTS HAD WAIVED BY FAILING TO PLEAD, RAISE OR EVEN ARGUE.

The Michigan Court Rules require that defenses not asserted in the responsive pleading or by motion are waived:

> Under MCR 2.111(F)(3), affirmative defenses must be raised in the responsive pleading, unless they previously have been raised in a motion for summary disposition before the filing of a responsive pleading, MCR 2.111(F)(2)(a). The failure to raise an affirmative defense as required by the court rule constitutes a waiver of that affirmative defense.

Stanke v State Farm Ins, 200 Mich App 307, 312; 503 NW2d 758 (1993), citing *Campbell v St John Hosp,* 434 Mich 608, 616; 455 NW2d 695 (1990). MCR 2.111(F) provides in relevant part:

(2) *Defenses Must Be Pleaded;*

Exceptions. **A party** against whom a cause of action has been asserted by complaint, cross-claim, counterclaim, or third-party claim **must assert in a responsive pleading the defenses the party has against the claim. A defense not asserted in the responsive pleading or by motion as provided by these rules is waived,** except for the defenses of lack of jurisdiction over the subject matter of the action, and failure to state a claim on which relief can be granted. . . . (emphasis added)

MCR 2.111(F) also sets stringent time requirements for pleading affirmative defenses:

(3) *Affirmative Defenses.* Affirmative defenses must be stated in a party s responsive pleading, either as originally filed or as amended in accordance with MCR 2.118. Under a separate and distinct heading, a party must state the facts constituting

(a) an affirmative defense, such as contributory negligence; the existence of an agreement to arbitrate; assumption of risk; payment; release; satisfaction; discharge; license; fraud; duress; estoppel; statute of frauds; statute of limitations; immunity granted by law; want or failure of consideration; or that an instrument or transaction is void, voidable, or cannot be recovered on by reason of statute or nondelivery;

(b) a defense that by reason of other affirmative matter seeks to avoid the legal effect of or defeat the claim of the opposing party, in while or in part;

> (c) a ground of defense that, if not raised in the pleading, would be likely to take the adverse party by surprise. (emphasis added)

Defendants did not raise *res judicata* at any time in this case, constituting a waiver of the defense. *Head v Benjamin Rich Realty Co, supra.* The Court of Appeals interjected the defense on its own initiative at oral argument, ignoring the clear requirements of MCR 2.111 and the strict adherence to its requirements by other panels of the Court of Appeals. See *Grzesick* v *Cepela*, 237 Mich App 554; 603 NW2d 809 (1999), wherein the Court of Appeals affirmed the trial court s ruling that pursuant to MCR 2.111(F)(3) defendant waived the affirmative defense of comparative negligence by failing to plead it in the second amended answer to plaintiff s counter-complaint.

Nothing about the defense of *res judicata* requires or allows a court to ignore the mandate of MCR 2.111(F). As the Supreme Court noted in *Pierson Sand Gravel, Inc. v Keeler Brass Co,* 460 Mich 372, 382-383; 596 NW2d 153 (1999):

> We must remember that this doctrine [*res judicata*] is not a constitutional mandate that must be carefully construed to maintain its integrity, but only a tool created by the courts. . . .The goal of *res judicata* is to promote fairness, not lighten the loads of the state court by precluding suits whenever possible.

The Court of Appeals should not have interjected the defense of *res judicata.* It was not raised below. It was not even raised prior to oral argument in the Court of Appeals. *Napier v Jacobs,* 429 Mich 222, 237-238; 414 NW2d 862 (1987); *Cremonte v Michigan State Police*, 232 Mich App 240, 591 NW2d 261 (1998). The Court erred by basing its ruling on a defense that Defendants did not even raise and by failing to address the merits of Plaintiff s claim.

III. THE RECORD DOES NOT ESTABLISH THAT DEFENDANTS COULD MEET THEIR BURDEN OF PROVING A *RES JUDICATA* DEFENSE.

The burden of proving the applicability of the doctrine of *res judicata* would have been upon Defendants had they asserted the defense. *Sloan v City of Madison Heights,* 425 Mich 288; 389 NW2d 418 (1986); *E & G Finance Co Inc v Simms,* 362 Mich 592; 107 NW2d 911 (1961). The Court of Appeals egregious error in asserting the *res judicata* defense for the Defendants is underscored by the fact that the record does not demonstrate that Defendants could have met their burden of proving the defense.

Res judicata bars a subsequent action between the same parties when the evidence or essential facts are identical. *Dart v Dart,* 460 Mich 573, 586; 597 NW2d 82 (1999); *Board of Eaton County Road Comm rs v Schultz,* 205 Mich App 371, 375; 521 NW2d 847 (1994); *Jones v State Farm Mutual Automobile, In Co,* 202 Mich App 393; 401; 509 NW2d 829 (1993). Defendants never developed a record from which either the Circuit Court (had it been asked to do so) or the Court of Appeals could find that Defendants could carry their burden of proving a *res judicata* defense.

The Court of Appeals attempted no analysis of the requirement that essential facts in the earlier action were the same as those herein, although it cited *Board of Eaton County Road Comm rs v Schultz, supra* at 375-376, in which the Court of Appeals had reaffirmed this as a requisite element for the defense to apply. In finding that *res judicata* applied to bar Plaintiff s claims herein, the Court of Appeals stated: _the over-arching issue in this case _ namely, whether post-production costs were deductible from royalties under the terms of the lease agreement_was resolved in the previous litigation. Probably

because the Defendants never raised the defense, the Court of Appeals did not consider that the instant action concerns totally different gas wells and that the type of costs being deducted and the manner of processing and marketing the gas may be totally different than what was done by Shell Oil Company with the wells it operated 20 years ago. If the defense was to be utilized, it was Defendants burden to establish what the essential facts were in each action and that they were identical. By asserting the defense on its own initiative, the Court of Appeals made its decision without even knowing whether a requisite element of the defense was or could be met.

Judge Porter s decision, on its face, suggests that the essential facts of the earlier action, *North Michigan Land & Oil, supra,* were not identical to the essential facts herein. That 1983 decision dealt with eight oil wells and one gas well. The instant case concerns 32 Antrim gas wells drilled by Mercury Exploration in the 1990's, years after the earlier action was concluded.

The Court of Appeals did note that different costs were involved in the instant case that were not part of the earlier action, stating:

> To the extent that the lower court did not address all issues that the parties properly raised below, and with regard to issues left unresolved by the trial court s decision in *North Michigan, supra,* [the prior action] we remand for a determination of these issues. . . We note that any issues that could have been raised but were not raised in the 1983 action are barred under the doctrine of res judicata. (**Attachment A**, pp 3-4)

In so ruling, the Court of Appeals made no comment concerning who had that burden of proof upon remand. However, the law is clear that the burden of proving *res judicata* is on the one asserting it. *Sloan, supra; E & G Finance Co, supra.* If the remand order is allowed to stand and Defendants decide to follow the Court of

Appeals lead and assert the defense as to costs challenged in the instant action but not in the prior action, Defendants will have to conduct extensive discovery to determine what costs could have been asserted, but were not, by the plaintiffs in *North Michigan Land and Oil, supra,* and *Melvin K. Neilson, et al, supra,* assuming such evidence still exists.

The Court of Appeals clearly erred in finding that the doctrine of *res judicata* applied to this case. The two causes of action are not the same, because the essential facts are not the same. Any application of decisions in the prior action to bar the present case would be a collateral attack, based on the doctrine of collateral estoppel. Collateral estoppel is an affirmative defense that the Court of Appeals did not discuss and one that was not raised by Defendants; therefore, that defense to was waived. (See Argument II, *supra.*)

Collateral estoppel, which bars the re-litigation of entire issues as opposed to specific claims, is a narrower doctrine than *res judicata.* As is the case with the *res judicata* defense, the burden of proof is on the one asserting the defense of collateral estoppel. *Detroit v Qualls,* 434 Mich 340, 357; 454 NW2d 374 (1990).

> The issue to be concluded must be the same as that involved in the prior action. In the prior action, the issue must have been raised and litigated, and actually adjudged. The issue must have been material and relevant to the disposition of the prior action. The determination made of the issue in the prior action must have been necessary and essential to the resulting judgment. (quoting from 1B Moore, Federal Practice, ¶0.443[1], p 759).

Collateral estoppel is applied when the two causes of action are different but share identical pertinent issues and involve the same parties. The requisite elements of the defense are: (1) the ultimate issue to be decided in second action is identical to the issue decided in the first; (2) the issues in the first case were

actually and necessarily litigated with a finding on which the judgment depended; (3) the parties in the second action were the same as or privy to parties in the first action. *Board of Eaton County Road Comm rs v Schultz, supra,* at 376.

Thus, to the extent that the Court of Appeals may have been saying _*res judicata* but meaning _collateral estoppel, it erred in stating that any _issues as distinct from _claims that could have been raised in the first action, but were not, are barred in the second. It further erred in stating that Judge Porter decided that a proportionate share of the _marketing costs, along with costs of dehydration, treatment and compression could be deducted from royalties.[6] Judge Porter, based on his reading of the royalty term in the leases, found only that the three costs at issue, dehydration, treatment and compression, were deductible costs.[7]

Also, any determination of the application of *res judicata* based on the 1983 decision of Judge Porter must be measured against the then-applicable court rule concerning joinder of claims, GCR1963, 202, and the impact of the waiver provision therein.[8]

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[6] See page 3 of Court of Appeals decision of December 6, 2002.

[7] _Plaintiffs herein bring the instant actions, now consolidated, to have such deductions of cost of treatment, dehydration and compression from the proceeds from the sale of the gas to Michigan Consolidated, adjudged improper under the instant lease agreements. **(Appendix Exhibit 17, p 4)** _For all of the reasons set forth above, the Court finds that defendants were and are entitled to apportion the costs of dehydration, treatment, and compression between themselves and lessees. **(Appendix Exhibit 17, pp 27-28)**

[8] GCR 202.1: Claims. A complaint shall state as a claim every claim either legal or equitable which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the same transaction or occurrence

Unless Shell Oil Company had objected to a failure of the North Michigan Land and Oil plaintiffs to join claims, the then applicable court rule provided that claims not then brought would not be barred in subsequent litigation. It was not until the 1999 amendment to MCR 2.203 that Michigan s joinder rule was changed to make it more compatible with *res judicata*. The Court of Appeals decision applies the 1999 amendment to actions which took place sixteen years prior to the effective date of that amendment.

IV. AN ISSUE OF LAW DECIDED IN A PRIOR ACTION SHOULD NOT BAR LITIGATION OF THAT ISSUE IN THE PRESENT CASE, ESPECIALLY WHERE THE PARTIES IN THE EARLIER CASE ARE NO LONGER BOUND BY THE DECISION AND A SUBSEQUENT COURT OF APPEALS DECISION CASTS DOUBT ON THE VALIDITY OF THE CIRCUIT COURT S RULING IN THE EARLIER CASE.

In ruling that the 1983 decision in *North Michigan Land and Oil* bars the present action as to all issues that were raised or

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that is the subject matter of the action and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction. **Failure by motion or at the pretrial conference to object to improper joinder of claims or a failure to join claims required to be joined constitutes a waiver of the required joinder rules and the judgment shall not merge more than the claims actually litigated.** (emphasis added.)

could have been raised in the 1983 action, the Court of Appeals stated:

> Applying the elements of *res judicata* to this case, first, the previous action was decided on the merits, and a final decision was reached. The fact that the previous litigation ultimately settled after the trial court s final order was issued does not preclude the order s *res judicata* effect. See *Ditmore v Michalik,* 244 Mich App 569, 576; 625 NW2d 462 (2001).

The Court of Appeals reliance on *Ditmore v Michalik, supra,* is misplaced. *Ditmore* did not address the issue of whether settlement of litigation after a final order is entered precludes the order s *res judicata* effect where the parties agree to resolve the legal issue in a manner inconsistent with the final order. In *Ditmore*, a consent judgment was entered in earlier litigation involving certain rights and restrictions on lots in a subdivision. The only ruling in *Ditmore* concerning settlement was the Court of Appeals observation that *res judicata* applies to consent judgments.

Res judicata has been held not to bar re-litigation of an issue of law where a new determination is warranted in order to take account of intervening changes in the law or to avoid inequitable administration of the laws. *Juncaj v C&H Industries, supra*; *Socialist Workers Party v Sec of State,* 412 Mich 571, 584; 317 NW2d 1 (1982); *Young* v *Detroit City Clerk*, 389 Mich 333, #339; 207 NW2d 126 (1973). The interpretation of the royalty clause of the leases was solely an issue of law for the court to decide. *G&A Inc v Nahra,* 204 Mich App 329; 514 NW2d 255 (1994). Judge Porter s decision interpreting the royalty clause as allowing the lessee to deduct certain costs from royalties should not bar Plaintiff s claim. The parties who actually litigated the issue before Judge Porter repudiated the decision in their stipulation for settlement entered in the Court of Appeals. **(Appendix Exhibit 18.)** Because the decision had been repudiated, the policy reasons behind the device of *res judicata* no

longer justify its application. See *Pierson Sand Gravel, Inc v Keeler Brass Co, supra.* Additionally, at the time of Judge Porter s decision, there was no Michigan case interpreting a royalty clause calling for payment of royalty on _proceeds from the sale of the gas . The Court of Appeals later decision in *Schroeder v Terra Energy, supra*, interpreted an _at the well royalty clause as opposed to a _proceeds royalty clause, and sheds light on the proper interpretation of a _proceeds royalty clause. In construing an _at the well clause, the Court of Appeals stated, in *Schroeder* at 187:

> The [t]erm _at the well is used as a way to allocate refining and transportation costs between the lessor and lessee. _At the well refers to proceeds minus refining and transportation costs, as opposed to proceeds at the point of sale, where refining and transportation costs are not deducted.

Thus, under the *Schroeder* analysis, if the royalty clause lacks the _at the well language, as herein, there is no authorization to deduct such costs from lessor s royalties.

The Supreme Court in *Pierson, supra,* at 382-383, viewed *res judicata* as a doctrine to promote fairness. The Court of Appeals application of a *res judicata* defense is particularly unfair under the circumstances of this case. The 1983 final order entered in the Crawford County cases is no longer enforceable against the parties in those cases because the parties, by their Stipulation for Settlement in the Court of Appeals, entered a contractual agreement to not abide by the order. If those parties in the earlier action retain any of their interests under the leases in question, they can enjoy receiving royalties from which no post production costs are deducted, while Plaintiff receives reduced royalties under the same leases. Further, the oil and gas leases at issue were based on Shell Oil Company s form lease which undoubtedly continues in widespread use in Michigan. With the exception of Plaintiff, parties to identical Shell leases are free to challenge whether their

lessees can deduct post-production costs under the terms of the identical royalty clause.

By the principles announced in *Juncaj, supra; Socialist Workers, supra;* and *Young, supra,* Plaintiff s claims herein should not be barred by Judge Porter s flawed legal interpretation of the royalty clause, an interpretation made more doubtful by the Court of Appeals later analysis in *Schroeder, supra.*

V. THE COURT OF APPEALS ERRED BY SUGGESTING THAT DIVISION ORDERS, RATHER THAN THE LEASE, WOULD CONTROL THE PAYMENT OF ROYALTIES AND REMANDING FOR A DETERMINATION OF WHETHER THE PARTIES EVER SIGNED DIVISION ORDERS.

The parties in this case have never contended that division orders were signed or if they were that such orders would control how royalties are to be calculated.[9] Yet, the Court of Appeals majority decision, citing cases from Texas, Arkansas and Ohio courts, inserted this entirely new issue into the case. Because there is no law in Michigan that even remotely suggests that a division order can change the terms of an oil and gas lease and no contention by any of the parties herein that division orders have such effect, it was error for the Court of Appeals to even broach the subject. Although it has no bearing on this case because no division orders were never signed, the Court of Appeals

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[9] _[W]e note that an important aspect of this case is that the lease was drafted in 1968. Currently, oil and gas producers and lessors use _division orders' to indicate who receives royalties and in what amount. **Attachment A,** page 3.

suggestion that division orders supercede oil and gas lease royalty language should not be allowed to stand because it is an incorrect statement of law.

VI. THE COURT OF APPEALS SHOULD HAVE RULED THAT THE CIRCUIT COURT ERRED IN HOLDING THAT THE ROYALTY CLAUSE OF THE LEASES ALLOWS DEFENDANTS TO DEDUCT POST-PRODUCTION COSTS NECESSARY TO RENDER THE RAW PRODUCT MARKETABLE AND SALEABLE AS GAS.

The failure of the Court of Appeals to make any analysis of the royalty clause is wholly inconsistent with its obligation to consider Plaintiff s appeal *de novo*. Paragraph 4 of the leases under which Defendants are obligated to pay royalties to Plaintiff states in pertinent part: _The lessee shall pay lessor, as royalty, one-eighth of the proceeds from the sale of gas , as such, produced from gas wells on leased premises . . . An oil and gas lease with this type of royalty clause is usually referred to as a _proceeds lease. *Hanna Oil and Gas Co v Taylor*, 759 SW2d 563 (Ark 1988).

In *Hanna Oil, supra,* at 564, the Arkansas Supreme Court stated: _Unless something in the context of an agreement provides otherwise, proceeds generally means total proceeds. Continuing at 565, the court also noted the first definition of _proceeds in Webster s New World Dictionary: _what is produced by or derived from something (as a sale, investment, levy, business) by way of total revenue: the total amount brought in: yield, returns. *Id.* The court noted that it was _unnecessary to go beyond the clear language of the agreement between the parties and held that the lessee was not entitled to deduct compression costs, stating: _If it had been their intention to do

so, they would have made some reference to costs, or net proceeds in the lease. *Id.*

Support for this definition of _proceeds is found within *Schroeder v Terra Energy, supra*, wherein the Court of Appeals, construing a royalty clause employing _gross proceeds at the wellhead terminology stated:

> [T]he term _at the well is used as a way to allocate refining and transportation costs between the lessor and lessee. **_At the well refers to proceeds minus refining and transportation costs, as opposed to proceeds at the point of sale,**
>
> **where refining and transportation costs are not deducted.**

Id, at 187. Thus, if the words _at the wellhead are what allows the lessee to deduct refining (processing) and transportation costs from _proceeds, as the Court of Appeals ruled in *Schroeder*, it logically follows that the _proceeds from the sale refers to the actual amount received when the gas is sold, before any deduction of lessee s post-production costs (refining or processing, transportation, etc.). Moreover, if there is any ambiguity in the royalty provision, such must be construed for the benefit of the lessor and against the lessee. *JJ Fagan & Co v Burns,* 247 Mich 674, 681; 226 NW 653 (1929).

In considering a nearly identical royalty clause in another _proceeds lease, the Supreme Court of North Dakota noted that two diverging lines of authority had developed in addressing whether or not the lessor should bear a portion of the expenses incurred by the lessee as operator. *West v. Alpar Resources, Inc.*, 298 N.W. 2d 484 (ND 1980). The *Alpar* court provided a detailed analysis of the cases from Kentucky, Kansas and Texas and the commentary from Williams, Kuntz and Merrill which supported an

interpretation of the royalty clause free from deductions. *Alpar, supra*, at 489. Eventually the court concluded that a case by case analysis would be required due to the variability in specific lease terms, the nature of the items to be deducted and the precise character of the royalty or other return to be paid or rendered. The Court went on to find that the proceeds lease royalty clause was ambiguous due to the absence of any explanation of how the royalty should be calculated, and that all ambiguities were to be resolved in favor of the oil and gas lessor and against the lessee as drafter of the lease. *Id. at 490.* This Court said the same thing in *JJ Fagan, supra, at 688.* The *Alpar* court concluded that the Lessors, the Wests, were entitled to royalty payments based upon a percentage of total proceeds without any deduction for any cost incurred by defendant. The Court also noted that lessee had the power to expressly provide for the deduction of expenses, which it failed to do.[10] Likewise, the Leases in question here could have been written by the Lessee to provide for the deduction of expenses, but no such provision was included.

Because the Michigan Court of Appeals in *Schroeder* recognized that proceeds not expressly limited to calculation _at the well are not to bear a share of the lessee s refining and transportation costs, the circuit court should have followed the law of this state and the reasoning of the highest courts of other states and concluded that the plain terminology in plaintiffs lease requires their royalty to be calculated on gross proceeds.

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[10] In the opinion of Judge Porter in *North Michigan Land & Oil, supra*, relied upon by the Court of Appeals, he comments on *Alpar* and other cases cited by plaintiffs therein: _The Court finds that although such cases are indistinguishable, their rationale is unpersuasive. He makes no reference to the decision in *JJ Fagan & Co. v. Brown, supra.*

The leases do not expressly allow any deduction of costs. There is no language within the four corners of the lease that rationally suggests that any costs may be deducted by the lessees. A court is not free to impose its own view of how business should be conducted between contracting parties in place of what the contract clearly states, as the Circuit Court did herein.

> Whatever may be the inaccuracy of expression or the inaptness of words used in an instrument in a legal view, if the intention of the parties can be clearly discovered, the court will give effect to it and construe the words accordingly. . . It is not within the function of the judiciary to look outside of the instrument to get at the intention of the parties and then carry out that intention regardless of whether the instrument contains language sufficient to express it; but their sole duty is to find out what is meant by the language of the instrument.

Michigan Chandelier v Morse, 297 Mich 41, 49; 297 NW 64 (1941).

The royalty clause does not specify where the sale of the gas must take place or that the proceeds have to be calculated where the gas first comes out of the ground, i.e. at the wellhead, or at any other particular place. There are no limitations on the point in the production process that the lessee is to measure the proceeds. Nor is _proceeds defined in the leases. The only logical conclusion that can be drawn from the actual words of the royalty clause is that _proceeds is whatever amount that the lessee receives upon selling the gas, regardless of where that sale takes place. _[T]he concept of proceeds looks to the receipts from the sales of petroleum products, wherever made. Hemingway, the Law of Oil and Gas (3d ed), Ch 7, 7.4, p 376. If the original lessee wanted authority to deduct costs it could have added _a few apt words to the leases to provide itself with the right to deduct costs from the royalties. *JJ Fagan* at p. 81.

Alternatively, the circuit court might have found the royalty clause to be ambiguous, and to have strictly interpreted that clause against defendants.

All three Defendants accepted assignments of interests in the three leases, the express terms of which did not authorize them as lessees to pass on a pro rata share of their post-production costs to Plaintiff-Lessor. They should not have been allowed to re-write the clear terms of the lease to their advantage and to Plaintiff s detriment.

VII. IN HOLDING THAT PLAINTIFF AS LESSOR MAY BE CHARGED WITH A PORTION OF THE SEVERANCE TAX AND PRIVILEGE FEE, THE COURT OF APPEALS ERRED IN SIMPLY RELYING ON ITS DECISION IN *BROWN V SHELL* WITHOUT RE-EXAMINING THE CORRECTNESS OF THAT DECISION.

Despite the severance tax act s imposition of the severance tax on gas producers who are engaged in the business of severing oil and gas, MCL 205.301, the Court of Appeals simply relied on *Brown v Shell,* 128 Mich App 111; 339 NW2d 709 (1983) and MCL 205.312 in ruling that _royalty owners are subject to the tax regardless whether they are actually engaged in the business of severing oil and gas from the soil. (See 3 of **Attachment A**.) It also concluded that _[b]ecause the supervisor of wells act incorporated the provisions of the severance tax act, see MCL 324.61524, it follows that plaintiff may also properly be charged a portion of the privilege fee assessed under the supervisor of wells act. (See 3 of **Attachment A**.)

Questions of statutory interpretation are reviewed by this Court *de novo, MCI Telecommunications,* 460 Mich 396, 413; 596

NW2d 164 (1999). As this Court stated in *Pohutski v Allen Park,* 465 Mich 675, 694; 641 NW2d 219 (2002): _[S]tare decisis is a principle of policy, not an inexorable command. [citation omitted] Stare decisis should not be applied mechanically to prevent this Court from overruling erroneous decisions regarding the meaning of a statute.

The Court of Appeals erred by failing to address Plaintiff s contentions that (1) by the terms of the statute, *Brown v Shell, supra,* was wrongly decided, (2) the basis for the *Brown* decision has been found to be erroneous in a subsequent Court of Appeals decision; and (3) the *Brown* decision is inconsistent with decisions of this Court.

A. Plaintiff, as Lessor of an Oil and Gas Lease, Is Not _a Producer Engaged in the Business of Severing Oil and Gas from the Soil.

The title of Michigan s Oil and Gas Severance Tax Act, 1929 PA 48, as amended by 1965 PA 299, MCL 205.301 *et seq,* states in pertinent part: _AN ACT levying a specific tax to be known as the severance tax upon all producers engaged in the business of severing oil and gas from the soil . . . Section 1 of the act provides:

> Sec. 1 There is hereby levied upon each **producer engaged in the business of severing from the soil, oil or gas,** a specific tax to be known as the severance tax.

MCL 205.301 (emphasis added). Producer is defined in subsection 12(2) as follows:

> Section 12(2) _Producer as used in this act means a person who owns, or is entitled to delivery of a share in kind or a share of the monetary proceeds

> from the sale of, gas or oil as of the time of its production or severance.

MCL 205.312(2).

In *Brown,* the Court of Appeals concluded that even though as of 1964 the severance tax may not have been a royalty owner s obligation, after the 1965 amendment to the statute, _because the severance tax is in lieu of other related property taxes, it is assessable against royalty holders as well as lessees who are actually engaged in the business of severing the oil or gas from the soil. *Brown* at 119. The court concluded that the tax was not in the nature of a business, licensing, privilege, or occupational tax. *Id.* Deduction of the privilege fee from royalties was not at issue in *Brown v Shell.* The _property tax ruling was the cornerstone of the *Brown v Shell* decision. However, the Court of Appeals in *Lawnichak v Dep t of Treasury,* 214 Mich App 618, 623; 543 NW2d 359 (1995), in upholding the severance tax against various constitutional challenges, treated that ruling as erroneous:

> Previously, a panel of this Court in *Brown, supra,* concluded by negative inference that the severance tax was a property tax. Having considered the question, **we conclude that the severance tax is in the nature of an excise tax as opposed to a property tax.** Consequently, the 1965 amendments of the act did not fundamentally change the nature of the tax and, therefore, there is no violation of Const 1963, art 4, sec 32 [_Every law that imposes, continues, or revives a tax shall distinctly state the tax.]. (emphasis added)

In *Cowen v Dep t of Treasury,* 204 Mich App 428, 432; 516 NW2d 511 (1994), the Court of Appeals stated that the language of the title of the severance tax act describes _an excise tax in the nature of payment for the privilege of taking gas and oil from the earth . . . The *Lawnichak* panel of the Court of Appeals

applied that interpretation but ignored the Michigan Supreme Court decision in *Mobil Oil Corp v Dept of Treasury*, 422 Mich 473; 373 NW2d 730 (1985). In that case, the lessee-oil producer, Mobil Oil, challenged the Treasury Department s inclusion of royalties paid to landowner-lessors in the lessee s single business tax base. It argued that the landowner-lessor is the appropriate taxpayer under the Single Business Tax Act, contending that a lessor of oil and gas rights has a property interest in the oil and gas as the lessor only partially transfers its rights to the lessee. *Id,* at 480-481. In rejecting Mobil s arguments, the Supreme Court recognized that the privilege of taking gas and oil from the earth rested solely with the lessee. *Id*, at 498. The Court observed that under the terms of the lease the landowner-lessor may not extract oil or gas from the property or transfer that right to another while the lease is in effect and concluded that _[t]he landowner-lessor, in oil and gas leases of this type, is not involved in production at all, but is merely a passive recipient of income and, therefore, should not be subject to the value added tax. *Id* at 498. Consistent therewith, it follows that because a royalty owner has no rights in the actual products of production, a royalty owner cannot be a _producer as defined in the severance tax act.

Mobil Oil v Dept of Treasury is fully consistent with the decision of the United States Court of Appeals for the District of Columbia in *Mobil Oil v Federal Power Comm*, 463 F2d 256 (DC Cir 1972), wherein that court recognized that a landowner who does nothing more than lease property for the exploration of natural gas is not in the business of producing or selling natural gas. In *Mobil Oil v Federal Power Comm,* the Federal Court of Appeals rejected the position of the Federal Power Commission that a lessor is a seller of gas produced from its lease and, therefore, subject to regulation. It reasoned that because the royalty owner had no property rights in the gas after it leaves the well-mouth, it could not be a seller of the gas. *Id,* at 260. See *JM Huber v Denman* 367 F2d 104, 113-114 (Cir 5 1966). Despite the fact that the royalty owner may have had an economic

interest in the proceeds of sale by virtue of the lease, that did not make the royalty owner a seller:

> The developer of a shopping center does not become a seller of food because he leases to a supermarket on percentage rental terms. A patentee who licenses various manufacturers on a percentage basis is not generally considered the seller of the articles. Nor does the lessor become a seller of an article merely because the article is produced on or from the land that he leased. An owner of farmland leased to a farming tenant does not become a seller of produce raised because his rent may be a fraction of the price received for the crops. An owner of a mine leased to an operator does not become a seller of the ore produced because the stipulated compensation for the lease is a fixed fraction of the price received for the ore produced.

Mobil Oil v Federal Power Comm, supra, at 262-263.

In a decision parallel to *Mobil Oil Corp v Dept of Treasury, supra,* this Court has also held that a *bona fide* lessor of real property, a position held by Plaintiff, is not liable for taxes incurred by the business conducted by the lessee on those premises. *Detroit Hilton v Dep t of Treasury,* 422 Mich 422; 373 NW2d 586 (1985). In *Detroit Hilton*, this Court agreed with Hilton that, as a commercial landlord to a tenant operating a hotel, Hilton did not incur sales, use and withholding tax liability associated with those hotel operations. To conclude, as the Court of Appeals did, that Plaintiff is obligated to bear a portion of an excise tax on the privilege of taking gas from the earth when only the lessee has that privilege conflicts directly with the reasoning of *Detroit Hilton, supra.* In short, there is no room for contending that Plaintiff is _engaged in the business of severing oil and gas from the soil and there is no basis in the severance tax act for

imposing a tax burden upon the lessor or relieving the lessee of its legal burden.

As for the Court of Appeals assertion that the severance tax was amended to expressly add royalty owners, such is inconsistent with the legislative history as revealed in a May 3, 1965 analysis of the 1965 Amendment submitted to the legislature by Gerrit Van Coevering, Deputy Commissioner of Department of Revenue. **(Appendix Exhibit 20.)** The analysis described the bill as a technical amendment to the existing severance tax act, with no revenue or budgetary implications. The analysis further advised that the amendment contemplates a change in procedure to conform with the present accounting and business practices under the present statute, [which] in substance, requires that the tax be paid by the purchaser of the oil and gas with appropriate reports.

B. Plaintiff, Having No Property Rights in the Oil and Gas Produced, Should Not Have to Bear a Portion of the Supervisor of Wells Privilege Fee.

In addition to the severance tax, a privilege fee is also assessed upon oil and gas produced in Michigan pursuant to the supervisor of wells act, section 61524, which states in pertinent part:

> (1) For the purposes of monitoring, surveillance, enforcement and administration of this part, a fee not in excess of 1%, based upon the gross cash market value, is levied upon oil and gas produced in this state. **The fee shall be collected by the revenue division of the department of treasury in the same manner, at the same time, and subject to the provisions of the tax levied by 1929 PA 48, MCL 205.301 to 205.317.**

MCL 324.61524(1) (emphasis added). Although the operator of a well is defined as the producer, MCL 324.61501(l), the statute does not identify the person who is to pay the assessed fee. In fact, the fee is not assessed upon a person. Rather, the fee is levied upon the gas itself. The lessor does not own the gas. *Mobil Oil v Federal Power Comm, supra; J. M. Huber v Denman, supra.* Moreover, the lessor does not have the privilege of extracting the gas, having transferred that right, exclusively, to the lessee. *Mobil Oil Corp v Dept of Treasury,* at 479. The supervisor of wells act only references the severance tax act for the manner of collection of the fee. It does not attempt to impose liability upon a lessor.

There is no provision in either the severance tax act or the supervisor of wells act to support the contention that Plaintiff has a property right in the gas such as to impose upon it the burden of a share of the privilege fee that is the sole obligation of the owner of the gas, the lessee. Plaintiff is merely the owner of oil and gas interests and, by virtue of the leases, is entitled to the payment of royalties on the sale of gas or oil by its lessee. It is only a _passive recipient of income. It should not be subject to the privilege fee.

CONCLUSION AND PRAYER FOR RELIEF

Injustice has been licensed and damage done to Michigan s jurisprudence. At the trial court level, the Circuit Court concluded that there is no difference between a _proceeds lease and a _wellhead lease, despite crucially different language in the royalty provisions, and despite the Court of Appeals prior decision in *Schroeder* which recognized that distinction. The issue was wrongly decided by the Circuit Court, contrary to the law of the State of Michigan.

That error, and jurisprudential damage, was then compounded by the Court of Appeals when it affirmed the trial court s ruling, not based on the Circuit Court s analysis (perhaps because that analysis was virtually nonexistent) but based upon the affirmative defense of *res judicata.* That defense, interjected *sua*

sponte by the Court of Appeals had not been previously raised by either party, not briefed, and specifically, waived by Court Rule. More importantly, the required elements of the doctrine were not established, even by the Defendant-Appellee who benefitted from its interjection. Moreover, *res judicata* is not applicable. This case and the prior case relied upon by the Court of Appeals do not rest upon the same set of facts, being separated by more than 20 years and focused on different wells, different geographic locations, different processing, and different costs being deducted. There is no basis for concluding that the defense should apply, and to affirm an erroneous decision based upon an inapplicable defense that had already been waived is, simply, a miscarriage of justice.

Equally, to ignore the plain words of the severance tax act and the supervisor of wells act and impose liability on literally thousands of landowners and concomitantly relieve the true taxpayers identified by the legislature of a portion of their tax burden, cannot be justified. Courts are to apply taxing and other statutes as written. They are not to interpose their own ideas and interpretations of what the law should be. Actions to the contrary should not be ratified.

This Court must bring consistency to Michigan jurisprudence in oil and gas law and related taxation. To allow this decision to stand (even as an unpublished decision) in direct conflict with *Schroeder, Mobil v Treasury* and other authority is to do harm to that body of law, and to leave trial courts without effective appellate guidance on these issues. More broadly, to allow the Court of Appeals to rely upon an affirmative defense that had been waived as its basis for upholding an erroneous decision as well as to apply *stare decisis* to unsound decisions is to give license to that Court to be biased and preferential, potentially in all areas of Michigan jurisprudence, in direct contravention of the Michigan Court Rules and the decisions of this Court.

The decision of the Court of Appeals is error. For the reasons set forth above, Plaintiff-Appellant requests that this Court grant leave to appeal, vacate the decision of the Court of Appeals and the Judgment and decision of the circuit court, grant summary disposition for Plaintiff and remand to the circuit court for a determination of damages and entry of judgment for Plaintiff.

Respectfully submitted,

ROSI & GARDNER, P.C.

Date: February , 2003 By: /s/_____

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APPENDIX H

STATE OF MICHIGAN
IN THE SUPREME COURT

SHR LIMITED PARTNERSHIP,
a West Virginia limited partnership,

Plaintiff-Appellant and
Counter-Defendant-Appellant,

v

MERCURY EXPLORATION CO.,
a Texas corporation,
and
DOMINION RESERVES, INC.,
a Michigan corporation,
and

Supreme Court
Case No._____
Court of Appeals
Case No. 232466
Otsego County
Circuit Court Case
No.99-8060-CK(D)

QUICKSILVER RESOURCES, INC.,
a Delaware corporation,

Defendants-Appellees,

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MOTION FOR RECONSIDERATION AND ARGUMENT IN SUPPORT

Plaintiff-Appellant moves for rehearing of this Court s order of July 28, 2003, denying Plaintiff s Application for Leave to Appeal. The Court of Appeals ruling which Plaintiff seeks leave to appeal is fraught with errors that could have far-ranging negative effects on Michigan s jurisprudence. Further, the Court of Appeals ruling in this matter disregards such important and fundamental concepts as due process and equal protection. Review of that decision by this, the Supreme Court of Michigan, is necessary in order to not only protect the rights of the litigants to this action, but, more importantly, to protect the rights of all future litigants in the State of Michigan.

Summary of Factual and Procedural History

A complete recital of the relevant factual and procedural history of this matter is contained in Plaintiff s Application for Leave to Appeal. Plaintiff s Application for Leave to Appeal (_ALA), pp. 1-4. In summary, Plaintiff is the lessor under oil and gas leases that provide for royalties on gas of _§ one-eighth of the proceeds from the sale of gas, as such, produced from gas wells on the leased premises. Plaintiff s suit challenged the propriety of Defendants deduction from

Plaintiff s gas royalties of a portion of expenses they incurred after gas was extracted from the ground, so called post-production costs. Plaintiff also challenged Defendants deduction from Plaintiff s gas royalties of a pro-rata portion of the severance tax and privilege fees paid by Defendants. The Otsego County Circuit Court rejected Plaintiff s challenge, granting Defendants summary disposition and ruling that each lease, as a _proceeds lease, had the same meaning as a _wellhead lease. It also ruled, without explanation, that the deduction of a share of severance taxes and privilege fees from royalties was allowable.

The Circuit Court decided that the royalty provision of the lease at issue permitted Defendants to deduct post-production costs _necessary to render the raw product marketable and saleable as gas and that the Severance Tax and Supervisor of Wells Acts require royalty owners on oil and gas leases to pay a proportionate share of Severance Taxes and Privilege Fees.

A majority decision by the Court of Appeals affirmed in part the Otsego County Circuit Court s January 23, 2003 Judgment, granting summary disposition for Defendants, basing its decision on grounds neither addressed by the Circuit Court nor raised by the parties in either the Circuit Court of the Court of Appeals. The Court of Appeals stated that its Opinion was to
be unpublished.[11] A copy of the Court of Appeals Opinion, with dissent is attached hereto as ***Exhibit A***. In an

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[11]The Court of Appeals statement that the opinion was to be unpublished is contrary to MCR 7.215(B). That Rule provides _[a] court opinion *must* be published if it: (1) establishes a new rule of law; (2) construes a provision of a constitution, statute, ordinance, or court rule; (3) alters or modifies an existing rule of law or extends it to a new factual

unprecedented decision, the Court of Appeals affirmed the Circuit Court s decision that Defendants could deduct post-production costs, not for the reasons given by the Circuit Court (which, in fact, the Court of Appeals expressly held were the _wrong reasons), but on grounds of *res judicata*, an affirmative defense that had neither been pleaded by Defendants nor briefed or argued by any of the parties in either the Circuit Court or the Court of Appeals. It also affirmed, again without explanation, the Circuit Court s decision concerning Plaintiff s obligation to bear a portion of taxes and fees imposed by the State upon Defendants. The intricacies of the issues involved and the inartful nature in which the Court of Appeals dealt with those issues were recognized by the dissenting judge in the Court of Appeals who noted, _I fear, the majority opinion takes a knotted ball of twine and simply tosses it back to the trial court to unwind. This is not an approach I can endorse, and I respectfully dissent as to those issues. ***Exhibit A***, page 2 of Dissent.

Plaintiff filed with this Court an Application for Leave to Appeal seeking review of the Court of Appeals decision. The errors noted in Plaintiff s ALA embraced issues fundamental and important to Michigan s jurisprudence,

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context; § (5) involves a legal issue of continuing public interest; § or _(7) creates or resolves an apparent conflict of authority, whether or not the earlier opinion was reported. The Court of Appeals opinion did more than one of these. Ignoring the rules and precedent regarding waiver of affirmative defenses must fit into one of the first three listed categories; expanding *res judicata* to give barring power to judgments abrogated by settlement between the parties on its face modifies or extends the current law. Many of the issues, especially those regarding affirmative defenses in general are of continuing public interest.

including due process, equal protection, waiver of defenses, misapplication and improper expansion of the doctrine of *res judicata*, the appearance of partiality by a tribunal, and the Court of Appeals disregard for new developments in the law, among others.

On July 28, 2003, this Court denied Plaintiff s Application stating, _we are not persuaded that the questions presented should be reviewed by this Court. July 28, 2003 Order, attached as ***Exhibit B***. This Motion for Reconsideration followed.

Issues Requiring Review by This Court

The facts and occurrences forming the basis for several important issues were presented in Plaintiff s Application for Leave to Appeal. Among such issues:

1. The Court of Appeals utter disregard of Michigan Court Rule 2.111(F) (ALA, ii, v, 2-3, 5);

2. The Court of Appeals refusal to follow precedent (ALA, ii, iv, 5-6);

3. The Court of Appeals violation of Plaintiffs due process rights, both substantive and procedural, as guaranteed by both the Michigan and United States Constitutions (ALA, iv, 6-8, 10);

4. The Court of Appeals violation of Plaintiffs constitutional rights of equal protection (ALA, v, 6-8);

5. The Court of Appeals failure to properly perform its duties including the failure to act as an impartial tribunal (ALA, v, 6-7, 14);

6. The Court of Appeals misapplication of the doctrine of *res judicata* caused by the Court s unconstitutional expansion of such doctrine (ALA, iv, 3-4, 7-8);

7. The Court of Appeals _form over substance position concerning settlement agreements and consent judgments in violation of equal protection (ALA v, 11-13); and

8. The Court of Appeals giving *res judicata* effect to a judgment that had been abrogated by the parties settlement agreement, which, as stated by the Court of Appeals in their decision, _reached a result opposite from the trial court s original ruling. ***Exhibit A***, page 1. (ALA, v, 10-13).

The Court of Appeals egregious errors regarding these issues must not go unreviewed by this Court. The errors committed fall into two broad categories: the Court s treatment of affirmative defenses in general, and the Court s misapplication of *res judicata*.

Errors in the* Sua Sponte *Raising of an Affirmative Defense

The first error was the Court s *sua sponte* interjection of the affirmative defense of *res judicata* as the basis for its decision, despite the fact that it was neither pleaded, briefed, nor argued by the parties. *Res judicata* was not raised until, at oral argument (for which no transcript exists) one appellate judge asked Plaintiff s counsel why a prior decision between

predecessors of the parties did not constitute a *res judicata* bar to Plaintiff s claims. In response, counsel advised the court that not only had the predecessors, during the appellate process, settled their controversy in a manner directly contrary to the judgment, but also, because the defense had not been raised, it had been waived. Affidavit of Philip R. Rosi, attached as ***Exhibit C***. The Court of Appeals recognized the existence of the settlement, but construed it to have no effect on *res judicata* as not being incorporated in an _agreed [consent] judgment. ***Exhibit A***, footnote 1, p. 2. It made no reference to _waiver and it ignored its own order dated February 12, 1985 entered in the matter and maintained within its own archives. A copy of the February 12, 1985 Order is attached hereto as ***Exhibit D***. That Order states

> IT IS HEREBY STIPULATED and agreed by all parties, by and through their respective counsel, that the pending appeal in this matter be dismissed, with prejudice and without costs, for the reason that the parties have reached an amicable settlement of all pending issues.

At the very least, that Order, by recognition of the settlement, supersedes the trial court order and, in any case, constitutes a subsequent _consent judgment that should have been recognized by the Court of Appeals.

The Michigan Court Rules unequivocally require that defenses not asserted in the initial responsive pleading (or a motion for summary disposition filed prior thereto) are waived. *Stanke v State Farm Ins*, 200 MichApp 307, 312; 503 NW2d 758 (1993); citing *Campbell v St John Hosp*, 434 Mich 608, 616; 455 NW2d 695 (1990). MCR 2.111(F) expressly codifies this case law, clearly stating that _A defense not asserted in the responsive pleading or by motion as provided by these rules is

waived. MCR 2.111(F)(2). The rules also, in MCR 2.111(F)(3), set forth the pleading requirements for properly raising, and hence avoiding waiver of, an affirmative defense.

Defendants never, at any time, raised *res judicata* in this case, thus waiving the defense. *Head v Benjamin Rich Realty Co,* 55 Mich App 348; 222 NW2d 237 (1974). The Court of Appeals discussed the defense on its own initiative at oral argument and interjected it in its opinion as the basis for its decision, ignoring the clear mandates of MCR 2.111 and the strict adherence thereto by other panels of the Court of Appeals. See *Grzesick v Cepala*, 237 MichApp 554; 603 NW2d 809 (1999) (Court of Appeals affirmed trial court s ruling that pursuant to MCR 2.111(F)(3) defendant waived affirmative defense of comparative negligence by failing to plead it in the second amended answer to plaintiff s countercomplaint).

Nothing about the defense of *res judicata* allows, let alone requires, a court to ignore the mandate of MCR 2.111(F)(3). The Supreme Court has stated that *res judicata*

> is not a constitutional mandate that must be carefully construed to maintain its integrity, but only a tool created by the courts ¶ The goal of *res judicata* is to promote fairness, not lighten the loads of the state court by precluding suits whenever possible.

Pierson Sand Gravel, Inc. v Keeler Brass Co, 460 Mich 372, 282-383; 596 NW2d 153 (1999).

The Court of Appeals committed manifest error by interjecting the defense of *res judicata.* The *sua sponte* interjection of the defense cannot remotely be considered

consistent with _fairness. It was not raised below. It was not even raised prior to oral argument in the Court of Appeals. In *Napier v Jacobs*, 429 Mich 222, 227; 414 NW2d 862 (1987), this Court reaffirmed the rule that the failure of a party to raise an issue waives review of that issue on appeal. The Court of Appeals plainly erred in basing its ruling on a defense that Defendants did not even raise and by thereafter failing to address the merits of Plaintiff s claim.

The due process issues involved in the Court of Appeals imposition of the defense which Plaintiff was not afforded an opportunity to defend against are inescapable. Constitutional due process requires notice and an opportunity to be heard; minimally: (1) notice of the time and place of hearing; (2) a hearing before a properly authorized body; (3) a reasonably definite statement of the charge or charges to be defended against; (4) the right to cross-examine adverse witnesses; (5) the right to produce witnesses on one s own behalf; and (6) a full consideration and a fair determination according to the evidence of the controversy by the hearing body. Michigan Civil Jurisprudence, Constitutional Law, 158. *LaChance v Bricson*, 522 US 262, 118 SCt 753, 139 LEd 695 (1998); *Dation v Ford Motor Co*, 314 Mich 152, 167; 22 NW2d 252 (1946); *Hansons v State Board of Registration in Medicine*, 253 Mich 601, 607; 236 NW 225 (1931). The Court of Appeals violated the Plaintiff s rights to due process by *sua sponte* raising the *res judicata* defense and deciding the case solely on that basis. Under MCR 2.117(F)(2), that defense had been waived. Moreover, the record was devoid of evidence to establish the elements of the defense, and Plaintiff had never had the opportunity, nor the need, to defend against it.

Further exacerbating the issue is the fact that the Court of Appeals went well beyond its authority under the rules in interjecting the affirmative defense and basing its conclusions thereon. MCR 7.210 states clearly and unquestionably that appeals are to be heard on the original record. Although MCR

7.216 allows the Court of Appeals to *permit* amendments, corrections or additions to the transcript or the record, or to remand the case for further evidence to be taken, it *does not* permit the Court of Appeals to make a determination based on something *not in the record* with the limited exception to avoid a miscarriage of justice, to prevent an egregious result, a power to be exercised quite sparingly. *Napier*, *supra*, 233. No miscarriage of justice or egregious result had the Court found otherwise is apparent on the record or alluded to by the Court.

The Court of Appeals failure to follow the Michigan Court Rules denied Plaintiff s due process rights by requiring Plaintiff, at oral argument, to defend against a claim which Plaintiff had no advance reason to believe it would be called upon to address. Recognizing the inherent differences between civil and criminal law, the Court of Appeals raising and deciding a case upon an affirmative defense not raised by a party smacks of the violation of due process condemned by the United States Supreme Court in *Cole v Arkansas*, 33 US 196; 92 L Ed 644 (1948). There the Supreme Court stated, It is as much a violation of due process to send an accused to prison following conviction of a charge on which he was never tried as it would be to convict him upon a charge that was never brought. *Id* at 201. Equally, a civil litigant has the right to rely upon the uniform application of Court Rules and should not be required, at oral argument on appeal, to defend against a claim (or affirmative defense) which was never tried (i.e. no evidence was gathered upon) *and* for which he was never charged (i.e. the defense was never brought, and hence, waived).

The Court of Appeals error did not end with the *sua sponte* interjection of a waived defense. That error was compounded with an unjustified burden shift that accompanied such interjection. When one of the judges on the Court of Appeals panel raised the defense of *res judicata*, he did not ask Defendants counsel, Does *res judicata* apply to bar this

claim against your client? Instead, he asked Plaintiff s counsel why *res judicata* did not bar his claim. It is the burden of the party asserting *res judicata* to prove that the defense applies. It *is not* the burden of the party against whom the defense is asserted to prove that it *does not* apply. *Sloan v City of Madison Heights,* 425 Mich 288; 389 NW2d 418 (1986); *E & G Finance Co Inc v Simms,* 362 Mich 592; 107 NW2d 911 (1961). The Court s shifting of the burden, in essence, required Plaintiff to prove, as an additional element of its claim, that *res judicata* was inapplicable. This burden shifting constituted another violation of Plaintiff s constitutional rights, this time, those of Equal Protection. Equal Protection prohibits disparate treatment of one party, or class of parties, from others similarly situated where the reason for such disparate treatment is arbitrary and capricious. *Crego v Coleman*, 463 Mich 248; 615 NW2d 218 (2000) *cert denied*, 531 US 1074, 148 LEd2d 667 (2001). The equal protection guarantees granted by the Constitution require that States treat like cases alike, while they may treat unlike cases accordingly. *Vacco v Quill*, 521 US 793, 138 LEd2d 834 (1997). The Court of Appeals, for no reason at all, required Plaintiff in this cause to prove not only its claim, but also that an affirmative defense did not apply thereto – an element additional to those required to be proven by other plaintiffs.

By interjecting an affirmative defense which had not been raised by the parties and shifting the burden, requiring Plaintiffs to prove that the affirmative defense did not apply, the Court of Appeals failed in its duty to act as an impartial tribunal. Plaintiff does not suggest that the Court of Appeals purposely took sides and showed bias against Plaintiff by so doing. However, Plaintiff feels compelled to illuminate the apparent partiality inherent in a court s raising a defense in a defendant s favor, shifting from a defendant the burden of proving that defense by requiring the plaintiff to prove that the defense does not apply, and then basing its decision solely on that defense even though the record does not contain the

evidence necessary to support the required elements of such defense.

The Court of Appeals *sua sponte* interjection of an affirmative defense nullifies the Michigan Court Rules regarding the pleading and waiver of such defenses and denies parties against whom such a defense is interjected their day in court, guaranteed to them by the Michigan and United States Constitutions. Shifting the burden from Defendants to the Plaintiff violates equal protection and contradicts established case law and practice within this State. Lastly, making a decision based on a defense which the parties were not given an opportunity to present or defend against and, therefore, of which the record does not include legal or factual support further violates Plaintiff s due process rights.

***Errors Regarding the Misapplication and Expansion of* Res Judicata**

The defense of *res judicata* bars a subsequent action on claims previously brought or which could have been brought between the same parties when the evidence or essential facts are identical. *Dart v Dart,* 460 Mich 573, 586; 597 NW2d 82 (1999); *Board of Eaton County Road Comm rs v Schultz,* 205 Mich App 371, 375; 521 NW2d 847 (1994); *Jones v State Farm Mutual Automobile, In Co,* 202 Mich App 393; 401; 509 NW2d 829 (1993). Defendants never developed a record from which either the Circuit Court (had it been asked to do so) or the Court of Appeals could conclude that Defendants had met their burden of proving a *res judicata* defense.

The Court of Appeals made no analysis of the requirement that essential facts in the earlier action were the same as those herein, although it cited *Board of Eaton County Road Comm rs v Schultz, supra* at 375-376, in which the Court of Appeals had reaffirmed this as a requisite element for application of the defense. In applying *res judicata* to bar

Plaintiff s claims, the Court of Appeals stated: _the over-arching issue in this case _ namely, whether post-production costs were deductible from royalties under the terms of the lease agreement_ was resolved in the previous litigation. The Court of Appeals failed to consider that the instant action concerns totally different gas wells using different technology and that the type of costs being deducted and the manner of processing and marketing the gas may be totally different from those applied by Shell Oil Company with wells it operated 20 years ago. If the defense was to be utilized, it was Defendants burden to establish what the essential facts were in each action and that they were identical. By asserting the defense on its own initiative, the Court of Appeals made its decision without even knowing whether each requisite element of the defense was or could be met. As noted above, this constitutes violation of Plaintiff s due process and equal protection rights.

It cannot be more clear that the Court of Appeals erred in finding that the doctrine of *res judicata* applied to this case. The two causes of action are not the same, because the essential facts are not the same. Any application of decisions in the prior action to bar the present case would have to be a collateral attack, based on the doctrine of collateral estoppel. Collateral estoppel is an affirmative defense that the Court of Appeals did not discuss and it too was not raised by Defendants. It too was waived.

Collateral estoppel, which bars the re-litigation of entire issues as opposed to specific claims, is a narrower doctrine than *res judicata*. As is the case with the *res judicata* defense, the burden of proof is on the one asserting the defense of collateral estoppel or, presumably, on the party for whose benefit the defense is asserted. *Detroit v Qualls,* 434 Mich 340, 357; 454 NW2d 374 (1990).

> The issue to be concluded must be the same as that involved in the prior action. In the prior action, **the issue must have been raised and**

> **litigated, and actually adjudged**. The issue must have been material and relevant to the disposition of the prior action. The determination made of the issue in the prior action must have been necessary and essential to the resulting judgment. (quoting from 1B Moore, Federal Practice, ¶0.443[1], p 759).

Id [emphasis added].

Collateral estoppel is applied when the two causes of action are different but share identical pertinent issues and involve the same parties. The requisite elements of the defense are: (1) the ultimate issue to be decided in second action is identical to the issue decided in the first; (2) the issues in the first case were actually and necessarily litigated with a finding on which the judgment depended; (3) the parties in the second action were the same as or in privity with parties to the first action. *Board of Eaton County Road Comm rs v Schultz, supra,* at 376.

Thus, to the extent that the Court of Appeals may have been saying _*res judicata* but meaning _collateral estoppel, it erred in stating that any _issues as distinct from _claims that could have been raised in the first action, but were not, are barred in the second. ***Exhibit A***, p. 4. It further erred in holding that the Circuit Court in the prior case decided that a proportionate share of the _marketing costs, along with costs of dehydration, treatment and compression could be deducted from royalties.[12] The Circuit Court, based on its reading of the royalty term in the leases, found only that the three costs at

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[12] See page 3 of Court of Appeals decision of December 6, 2002.

issue, dehydration, treatment and compression, were deductible costs.[13]

The Court of Appeals error is further compounded by the nature of the judgment to which it choose to give *res judicata* effect. The Court of Appeals recognized in its Opinion that the parties to the prior action reached a settlement while appeal was pending and that such settlement _reached a result opposite from the trial court s original ruling. ***Exhibit A***, p. 2. The Court of Appeals went on to make the absurd ruling that _[t]he fact that the previous litigation ultimately settled after the trial court s final order was issued does not preclude the order s res judicata effect. ***Exhibit A***, p. 2.[14] The Court of

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[13] _Plaintiffs herein bring the instant actions, now consolidated, to have such deductions of cost of treatment, dehydration and compression from the proceeds from the sale of the gas to Michigan Consolidated, adjudged improper under the instant lease agreements. **(ALA Appendix Exhibit 17, p 4)** _For all of the reasons set forth above, the Court finds that defendants were and are entitled to apportion the costs of dehydration, treatment, and compression between themselves and lessees. **(ALA Appendix Exhibit 17, pp 27-28)**

[14]Also in need of review is the Court of Appeals citing of cases for propositions *not* remotely related to the issues decided in those cases. The Court of Appeals cited *Ditmore v Michalak*, 244 MichApp 569, 576; 625 NW2d 462 (2001), for the proposition that _the fact that the previous litigation ultimately settled after the trial court s final order was issued does not preclude the order s res judicata effect. ***Exhibit A***, p. 2. *Ditmore*, where cited, however, stands for the proposition that consent orders can have *res judicata* effect, a far cry from the Court of Appeals proposition.

Appeals footnotes that the settlement from the prior litigation does not have *res judicata* effect because it was not entered in the form of a consent judgment. ***Exhibit A***, p. 2. The Court, however, ignored the Order it itself entered dismissing the appeal in the prior action which stated that the dismissal was issued _for the reason that the parties have reached an amicable settlement of all pending issues. ***Exhibit D***. That dismissal Order, not the trial court s judgment, was the <u>final</u> order/judgment in the case and it includes, through reference thereto, the parties settlement agreement. That Order dismissing the case, by its nature as the order finally disposing of the case, should trump the *res judicata* effect of the trial court judgment.

Ignoring its own order and giving more import to the initial judgment that the subsequent settlement places form over substance. This _form over substance ruling seems to indicate that settlements embodied in consent judgments have a binding effect on the parties thereto over and above that of settlement agreements not put into consent judgments. The myriad issues presented by this ruling include equal protection violations involved with granting different rights to parties who use consent judgments than those who simply settle and dismiss a case.

By giving *res judicata* effect to the prior ruling, minimizing the subsequent settlement and ignoring the actual final order, the Court of Appeals has raised issues of great importance to the jurisprudence of this State. As set forth earlier, the Michigan Supreme Court has stated that the _[t]he goal of res judicata is to promote fairness § *Pierson Sand Gravel, Inc*, *supra*. Using *res judicata* to abrogate a settlement voluntarily entered into by the parties, or by their successors in interest, can in no way be seen as promoting fairness.

The Court of Appeals use of the prior decision in its application of *res judicata*, ignoring its own order, will have a

disastrous effect on settlements. The chilling effect that such a decision could have on settlements after trial, while appeal is pending, is undeniable. If the Court of Appeals decision is allowed to stand, then parties who have _lost at trial court would be loathe to enter into settlements, even those entirely in their favor, and even if incorporated in subsequent orders of the Court of Appeals, because any dispute arising subsequent to the settlement would be decided based on the *res judicata* effect given to the prior, abrogated judgment. Similarly, parties who have _won at trial would be unlikely to agree to consent judgments when settling cases during an appeal s pendency, not wanting to lose the potential binding effect of the prior judgment.

The Court s misapplication of *res judicata* and its expansion of the doctrine to bar litigation on *claims* dealing with *issues* similar to those in claims previously litigated (even if such claims could not have been part of the prior litigation) will have far-reaching negative effects on Michigan jurisprudence if allowed to stand. The Court s ruling, if made a part of the jurisprudence of the state, has the effect of closing the doors of the court to parties whose rights have been trampled simply because the party now victimizing them has trampled their rights before in a similar fashion.

Conclusion

The Court of Appeals actions leading to its decision, as well as the decision itself, are in desperate need of review by this Court. The fact that the Court of Appeals stated that its opinion was to be unpublished[15] does not remove the injustice that was done to the parties to this litigation, nor does it, in any meaningful way, lessen the harm such a decision causes to

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[15]In direct contradiction to MCR 7.215(B), *see footnote 1, supra.*

Michigan s jurisprudence. Allowing the Court of Appeals actions and opinion in this case to stand gives the Court of Appeals license to choose to apply or disregard Michigan Court Rules at its whim, to apply legal doctrines such as *res judicata* without truly understanding the doctrine (and without establishing that it truly applies), all to reach results contrary to the doctrine s goal of promoting fairness. Further, as expanded and applied by the Court of Appeals in this case, *res judicata* becomes an unconstitutional violation of due process, allowing a court to bar claims which could not have been brought at an earlier time.

This Court is duty bound to remedy the unjust, erroneous, and unconstitutional decision of the Court of Appeals. Plaintiffs ask, therefore, that this Court fulfill that duty by reviewing the Court of Appeals opinion in this case, remediating the errors replete throughout that opinion, and setting Michigan s jurisprudence aright. Refusal by this Court to review the decision below will harm not only Plaintiffs herein, but all future litigants in the State of Michigan who will be unable to rely on the Court Rules and law of the State of Michigan, and whose rights the Court of Appeals will have been given license to ignore.[16]

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[16]Other issues and errors of the Court of Appeals raised in Plaintiffs Application for Leave to Appeal, including but not limited to the error regarding remand for consideration of division orders; lower court rulings on the Severance Tax Act and the Supervisor of Wells Act; and the issue of _proceeds versus _wellhead leases are not meant to be waived by this Motion for Reconsideration and are fully and adequately presented in pages 13-22 of the Application for Leave to Appeal. This Motion was meant to show this Court the dire need of review of the Court of Appeals decision and thus concentrated on the errors in that decision with the most disastrous and far-ranging consequences on

Wherefore, Plaintiffs request that this Court reconsider its denial of Plaintiffs Application for Leave to Appeal, accept such Application, and correct the errors of both the trial court and the Court of Appeals.

Respectfully submitted,

ROSI & GARDNER, P.C.

Date: August 13, 2003 By: /s/

Philip R. Rosi (P31915)
Counsel for Plaintiff-Appellant
735 S. Garfield Avenue, Suite 202
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(231) 941-5878

Michigan s jurisprudence and the rights of litigants in Michigan.

APPENDIX I

STATE OF MICHIGAN
IN THE SUPREME COURT

SHR LIMITED PARTNERSHIP,
a West Virginia limited partnership,

Plaintiff-Appellant and
Counter-Defendant-Appellant,

v

MERCURY EXPLORATION CO.,
a Texas corporation,
and
DOMINION RESERVES, INC.,
a Michigan corporation,
and
QUICKSILVER RESOURCES, INC.,
a Delaware corporation,

Defendants-Appellees,

Supreme Court
Case No._____
Court of Appeals
Case No. 232466
Otsego County
Circuit Court Case
No. 99-8060-CK(D)

Philip R. Rosi (P31915) Rosi & Gardner, P.C. Attorneys for Plaintiff-Appellant 735 S. Garfield, Suite 202 Traverse City, MI 49684 (231) 941-5878	James R. Neal (P24265) Gary L. Field (P37270) Attorneys for Defendants-Appellees 232 S. Capitol Ave., Ste. 1000 Lansing, MI 48933-1525 (517) 482-2400

AFFIDAVIT OF PHILIP R. ROSI

Philip R. Rosi, being duly sworn, says if called to do so, I am competent to testify, from first-hand knowledge, to the facts stated herein:

1. I am a resident of the Township of Peninsula, County of Grand Traverse, State of Michigan.

2. I am an attorney licensed to practice in the State of Michigan and have been so licensed since 1981.

3. I am counsel for SHR Limited Partnership and have been throughout the entirety of the subject litigation.

4. I was counsel for SHR Limited Partnership at the time of oral argument in this case held before the Michigan Court of Appeals.

5. In the course of oral argument, Court of Appeals Judge O Connell raised with Affiant the question of whether a prior decision in *North Michigan Land & Oil Corp. v Shell Oil Company* and *Nielson v Shell Oil Company* constituted res judicata to the issues at hand.

6. In response, I provided an explanation as to why I did not believe that *res judicata* applied including, among other things, that the parties had settled the matter of contrary to the provisions of the Circuit Court Judgment entered in that case.

7. In addition, I stated that, as he recalled, the issue of *res judicata,* an affirmative defense, had never been raised and therefore it had been waived.

7. To the best of my recollection, no member of the panel of the Court of Appeals addressed any question regarding res judicata to Attorney Gary L. Field, counsel for Defendants.

Further Affiant sayeth not.

Date: August 13, 2003 /s/
Philip R. Rosi

STATE OF MICHIGAN)
COUNTY OF GRAND TRAVERSE)

Personally appeared before me Philip R. Rosi, who swore to the truth of the foregoing of his own personal knowledge. Subscribed and sworn to me this 13th day of August, 2003.

/s/
Virginia Rautiola, Notary Public
Grand Traverse County, Michigan
My commission expires:, 06-01-04

APPENDIX J

STATE OF MICHIGAN

IN THE COURT OF APPEALS

On Appeal From The Circuit Court
For The County of Crawford

NORTH MICHIGAN LAND & OIL CORPORATION,

Plaintiffs and Appellants,

vs.

Court of Appeals
Case No. 77304 G

SHELL OIL COMPANY,
(Now Shell Western E&P, Inc.)

Crawford County
Case No. 80-004-292-CK

Defendant and Appellee.

/

MELVIN K. NIELSON, ERNEST S. CORNWALL, and ELLA H. BRAUN, TRUSTEES OF SALLING HANSON COMPANY,

Court of Appeals
Case No. 77305 G

vs.

SHELL OIL COMPANY,
(Now Shell Western E&P, Inc.)

Crawford County
Case No. 80-004-294-CZ

Defendant and Appellee.

/

STIPULATION FOR DISMISSAL OF APPEAL

IT IS HEREBY STIPULATED and agreed by all parties, by and through their respective counsel, that the pending appeal in this matter be dismissed, with prejudice and without costs, for the reason that the parties have reached an amicable settlement of all pending issues.

Dated: February 12, 1985

/s/
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(P13803)
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/s/
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